Commission of Inquiry
into
Residential Tenancies

Ontario

The Normative Bases of Government Action

W. T. Stanbury

Research Study No. 16

THE NORMATIVE BASES OF GOVERNMENT ACTION

by

W.T. Stanbury

Research Study No. 16

Commission of Inquiry

into Residential Tenancies

Toronto

Published by the Commission of Inquiry
into Residential Tenancies, November 1985

Printed in Canada

ISSN - 0823-4418
ISBN - 0-7729-1076-6

Copies of this report are available from
the Ontario Government Bookstore,
880 Bay Street,
Toronto, Ontario,
M7A 1N8.
Telephone: 416-965-6015; toll-free 1-800-268-7540;
area code 807, ask operator for Zenith 67200.

The views expressed in this paper are those of the
author and not necessarily those of the Commission.

W.T. STANBURY is UPS Foundation Professor of Regulation
and Competition Policy, Faculty of Commerce and Business
Administration, University of British Columbia.

PREFACE AND ACKNOWLEDGEMENTS

This study is one of three volumes prepared in draft form prior to the author's testimony before the Ontario Commission of Inquiry into Residential Tenancies beginning October 9, 1984. The other two studies are as follows:

- W.T. Stanbury, The Normative Bases of Rent Regulation, Research Study No. 15 (Toronto: Ontario Commission of Inquiry into Residential Tenancies, 1985); and
- W.T. Stanbury & Peter Thain, The Origins of Rent Regulation in Ontario, Research Study No. 17 (Toronto: Ontario Commission of Inquiry into Residential Tenancies, 1985).

This study provides the general conceptual framework for The Normative Bases of Rent Regulation. It seeks to group the various arguments for government action in the economy into three main categories: actions to improve economic efficiency; actions to alter the distribution of income; and actions designed to create rights.

I am indebted to the staff of the Word Processing Centre in the Faculty of Commerce at the University of British Columbia for extensive and cheerful assistance in the preparation of the manuscript and to Peter Thain for excellent research assistance. I am very grateful to John Todd and Don Jack for their helpful comments, and for their good humour under pressure.

W.T. Stanbury
Vancouver, B.C.
November, 1985.

TABLE OF CONTENTS

Chapter 1

INTRODUCTION

> The fundamental questions of political economics are "What part does the government play in the economy? What part should it play? How well does it do what it does?" Questions this big do not have simple and straight-forward answers (Alt and Chrystal, 1983, p. 3).

1.0 FOCUS AND APPROACH

In this study I focus on the arguments made in support of some form of government action. These are arguments why such action ought to be taken or why some public policy ought to be retained and modified to make it more effective from the point of view of its proponents.[1] These arguments, by definition, are based on value judgments. They are not designed to predict behaviour, but to alter it by persuasion. Of course, persuasion also depends on appeals to emotion as on logical argument buttressed by facts. This is particularly the case where individuals or groups are seeking government action to alter the distribution of income or wealth.

For some, the term government "intervention" is an emotionally loaded term implying that the absence of government actions in a market economy is the ideal social arrangement. Therefore, any action by government amounts to "unnatural" intervention in what is held to be a smoothly functioning situation. Yet the strongest proponents of a "virginal" market economy often ignore the fact that two of the foundations of a universal market economy, the institution of private property and the enforcement of contracts, require government intervention. Posner (1981, pp. 120, 121) suggests that

> Truly limited government has only one function -- to assure physical security in both its internal and external aspects ... Without some minimal internal public order, community welfare would be diminished.

Life without a government to protect the security of the individual and to define and enforce property rights would be neither just nor efficient. Rather it would be, like Hobbes' description, "poor, nasty, brutish and short". The proponents of extreme versions of laissez-faire (e.g., Nozick, 1974), in emphasizing the importance of individual freedom, ignore the fact that government action can both constrain and effectively enlarge the individual's freedom.

Because the phrase 'government action" is more neutral than "government intervention", I shall try to use it in this study. If the latter is used, however, the reader should not assume it has a pejorative meaning.

The number of arguments for a government to take a particular action to alter economic behavior are more numerous than the number of voters. I believe, however, that they can be grouped into three categories:

(1) Actions by government to improve the efficiency with which society's scarce resources are allocated by remedying various market failures (Chapter 2).

(a) Public Goods
(b) Externalities
(c) Imperfect Competition and Market Power (including natural monopoly)
(d) "Destructive Competition"
(e) Failure in the Assignment of Property Rights: Common Property Resources
(f) Imperfect Knowledge (Uncertainty)
(g) Transaction Costs

(2) Actions by government designed to alter the distribution of income, wealth or consumption opportunities (Chapter 3).

(a) Utilitarianism
(b) Meeting Basic Human Needs
(c) Eliminating/Ameliorating Poverty
(d) The Presumption of Equality
(e) Justice as Fairness
(f) Equality and Meaningful Choice
(g) Deservingness or Desert

(3) Actions by government to create rights and thereby remove certain things from the market exchange process (Chapter 4).

This study is one of three prepared as background material for the author's testimony as part of Task A of the second phase of the work of the Ontario Commission of Inquiry into Residential Tenancies. See Stanbury (1985) and Stanbury & Thain (1985). Task A was concerned with understanding the possible objectives of rent regulation as it does or ought to exist in the province of Ontario.

Preparation for the testimony on the normative arguments of rent regulation in Ontario proceeded in two stages. I began by reviewing the normative bases for government intervention to influence economic activity in general. The results of this work are reported in this volume. It provides the analytical framework for the discussion of the normative bases of one type of regulation in one jurisdiction, rent regulation in the province of Ontario -- see Stanbury (1985).

Why is this approach useful? First, an examination of the normative bases of all types of government intervention in the economy provides a general framework within which to analyze a specific public policy. An analytic framework that is larger and more general than the case at hand provides both perspective and a basis of comparison. There is a danger in analyzing a particular type of government action in isolation from other policies and from the bases of government action in general. The "uniqueness" of the problem may be exaggerated. What appears to be a special case may really, under a different label, be part of a much larger category about which we have both more theory and empirical evidence which may be brought to bear on the problem at hand. As I indicate in my study, The Normative Bases of Rent Regulation, despite the special terminology and particular issues, the arguments put forward in Ontario in support of rent controls are really a subset of the arguments for government intervention in general as discussed below.

Second, and more importantly, in light of the size and importance of government in the Canadian economy, it behooves us to inquire more closely into the normative arguments for government action in general. The evidence is clear that Canadians have a strong preference for government action in their economy. For example, Howard and Stanbury (1984) show that:

- Expenditures by all levels of government jointly amount to over 45% of G.N.P. in constant 1971 dollars. Transfer expenditures (i.e., purely redistributive payments) now exceed exhaustive expenditures. Governments collectively employ about one-quarter of Canada's employed labour force, more than one-half of whom work for Crown corporations.
- Government regulation is ubiquitous. About 30% of G.N.P. is subject to direct regulation (price and/or entry controls) of varying degrees.
- Federal "tax expenditures" or statutory exemptions, deductions or tax credits, if they were paid as subsidies, would increase federal expenditures by about 50%. These tax expenditures are heavily biased toward higher-income families.
- There are over 400 federal Crown corporations (including subsidiaries) and over 200 provincial Crown corporations (excluding subsidiaries). Thirty-nine of these firms were among the 500 largest non-financial enterprises in Canada in 1983. All federal Crown corporations now have more employees than do federal departments.
- Federal and provincial governments hold voting shares in over 300 <u>mixed</u> enterprises. These equity investments by governments amount to about 7.5% of all equity capital in Canada. See Elford and Stanbury (1985).
- Loans and loan guarantees by the federal and provincial governments represent an important source of financial capital in several sectors, e.g., housing, agriculture and export financing. Substantial subsidies are

often embedded in these loans/guarantees -- one estimate put the amount at about $1 billion in 1979. This figure does not include the more recent "bailouts".

- Although it is hard to document precisely, there is evidence that governments treat certain privately-owned firms as "chosen instruments" of public policy, e.g., Dome Petroleum, Nova Corp, Mitel Inc. The longer-term implications of this approach to government intervention are not clear.
- Finally, there is evidence that the federal government is making greater use of suasion to effect its purposes without resorting to more coercive governing instruments that require legislation, e.g., the "6 and 5" program 1982-84, and the efforts to induce Japan to "voluntarily" restrict its export of cars. See Stanbury & Fulton (1984).

Howard and Stanbury (1984) conclude that "Canada has become a government-centred society". It is essential, therefore, to understand the normative bases of government action in general.

2.0 POSITIVE THEORIES VERSUS NORMATIVE ARGUMENTS

March (1978, p. 588) notes that

> according to conventional dogma, there are two kinds of theories of human behavior: descriptive (or behavioral) theories that purport to describe actual behavior of individuals or social institutions, and prescriptive (or normative) theories that purport to describe optimal (or desirable) behavior. In many ways, the distinction leads to an intelligent fruitful division of labor in social science reflecting differences in technique, objectives and professional cultures.

I define the normative bases of government action as propositions advanced to indicate why and under what conditions it is desirable for society to take collective action in the form of government intervention to influence the economic behaviour of private sector actors.

Positive theories, on the other hand, are explanations of government action designed to be objective and without normative premises. Such theories attempt only to explain and/or describe, but not to evaluate according to normative criteria. See Stanbury & Thain (1985). Positive theories of government action are concerned with what is rather than what ought to be. There is a difference between saying what is the case; what ought to be the case; and what is necessary or instrumentally useful given what ought to be the case. To go from the first to the second or third statement requires some normative premise on which to predicate the subsequent normative proposition. "Positive analysis examines what transpires independent of and as a necessary prelude to judgement and evaluation" (Samuels, 1978, p. 62).

In the public policy context the emphasis in positive theories is on explaining why new legislation was enacted or why an existing policy was altered in a significant way. There is also an emphasis on predicting what is likely to occur under certain conditions. No consideration is given to whether or not the government action is desirable in some sense. In general, positive theories of government action tend to focus on political factors. Therefore, the role of interest groups, the motivation of politicians and the behaviour of marginal voters (or voters in marginal constituencies) are central in positive theories of government intervention. See Stanbury & Thain (1985) and Hartle (1984).

This conventional distinction between positive and normative analysis can be somewhat illusory and reflects the fact that "economists have a rather guilty conscience about values" (Evans, 1982, p. 454). The distinction can be illusory, because, as Evans (1982, pp. 454-55) reminds us, the analysts' values enter into positive theories as a preanalytical cognitive act: "What we choose to study, how we define the essential properties of the objects of analysis, and what we think are their significant, as opposed to incidental, inter-relationships, all depend on our value system." Moreover, "positive

analysis in practice always embodies a number of simplifying assumptions, empirical judgments, and often just plain guesses, to move it across the gaps in which empirical evidence is missing, or more commonly ambiguous. In this process, of course, value judgments play an inevitable role." Therefore, in proposing and testing positive theories, the careful analyst ought (a normative proposition in itself) to make the judgmental aspects evident and to make his (or her) judgments as explicit as possible.

3.0 OBJECTIVES VERSUS EFFECTS

It is important to distinguish between the objectives of a public policy and its effects. I use the word "objectives" to refer to the intended effects or desired results of government action. For example, the objectives of rent regulation may include keeping rent levels below the level that would occur if the private market was allowed to operate freely. A particular system of rent regulation may or may not hold rents below the market-clearing level. That is an empirical question. Moreover, if regulation does achieve the objective of holding rents below the market-clearing level, it may produce other effects ignored or unanticipated by the proponents of rent regulation.

While this study focuses on the normative bases of government action in general, it is useful to think for a moment about the concept of the effects of public policies. For example, I agree with Page (1983, p. 208), who argues that to understand the effects of government actions we must think in a general equilibrium fashion.

> It is not adequate to view government actions as tacked onto the private economy, simply adding to or subtracting from what the market does. Government actions themselves affect the "private" behavior of individuals and firms as they make choices about work, savings, production, investments, and even living arrangements and family life. These choices, in turn, affect other "private" choices and reverberate throughout the economy so that the net long-run impact of a government policy may be quite different from its apparent short-run effect.

Moreover, the time when the effects of government intervention will occur need to be specified. First, we must distinguish between short run effects and long run effects. In real time, the latter period refers to the time it takes for existing contracts to expire and new ones to be made, i.e., all factors become variables. In terms of a production process, there are no fixed costs. The long run refers to the changes that will occur over time as a new equilibrium is reached, barring further exogenous shocks.

Second, we must recognize that a policy is dependent upon the set of conditions in which it is embedded. Therefore, initially a policy change may produce effects quite similar to the objectives its instigators intended. However, the same government action may produce quite different effects (even contradictory ones) with the passage of time. This is not simply a matter of short run versus long run effects. Rather, the set of conditions (economic, social, political) in which the policy is embedded changes. Hence the effects it produces change. See, for example, the discussion in Stanbury & Vertinsky (1985).

4.0 PROBLEMS IN UNDERSTANDING THE NORMATIVE BASES OF GOVERNMENT ACTION

The most important reason for inquiring into the normative bases of government action lies in the nature of attempting to employ a rational approach to decision making and policy formulation. As Quade (1975, p. 20) points out, "if a study is to analyze all aspects of a decision problem, it must include the following:

1. An investigation of what it is the decision-maker seeks to accomplish...;
2. A search for alternative ways of achieving the objectives...;
3. A full comparison of the alternatives in terms of their impacts...;
4. A consideration of all significant aspects of the problem...; [and]
5. An interactive approach...".

But the analysis of objectives necessarily requires one to inquire into values and ultimate goals -- a task that is fraught with difficulty. The normative bases of many public policies are often vague or ill-defined. Vague legislative rationalizations are offered because the legislative decision involves the aggregation of conflicting preferences, and because legislation recognizes that there may be changes in the importance of the interest groups affected by a public policy. The tendency is for legislators to state objectives as broad statements of direction, rather than as a precise target.

The fact that public policies are vague or ill-defined reflects the "full richness of the political problem" (Hartle, 1979, p. 26). The problem is that even with "motherhood" statements, "goals are not independent of each other [e.g., full employment and price stability] nor of other goals; [and] voters are not indifferent about who will obtain the benefits and who will bear the costs" of achieving such goals (Ibid.). It may be easier for conflicting interest groups to agree on an action than it is for them to agree on a statement of purpose.

Any analysis of the goals of a piece of legislation (and the policy of which it is a part) must be cognizant of the possible differences between stated objectives and "true" objectives. For the most part, we are forced to work with the public statements of politicians, bureaucrats, academics, and interest groups. To only a limited extent can we verify such statements with reference to observed behaviour. But statements about the normative bases of a government policy may not closely coincide with either the administrative behaviour of the agencies which implement the legislation or the actual effect(s) of the legislation in practice. There are simply too many actors and too many intervening variables to determine the linkages precisely.

However, Stigler (1982) argues that where a policy has been in place for some time (i.e., its effects are known), it is reasonable to infer its

objectives from its effects. He argues that politicians both understand and implicitly endorse the consequences of long-standing policies that appear -- to economists and other policy analysts at least -- to be perverse in that they reduce the economic welfare of the nation as a whole. The Nobel Laureate in Economics points out that "if such policies were adopted in ignorance of their effects, we would be hard put to explain their form as well as their duration." With respect to the form of rent ceilings, he refers to the controls over conversions and demolitions, the exemption of new construction from the ceilings and the rights of tenants to sublease controlled dwellings. (For a more detailed discussion of the significance of the elements of a rent control system, see Stanbury & Vertinsky (1985).) Stigler (1982, p. 14) puts the point strongly when he says, "I believe that if we look at any important economic policy of the state, we shall find that it takes account of whatever established knowledge economists possess, and perhaps some we do not yet possess."

In the Canadian case we can point to the tariff. Theoretically and empirically the evidence of the adverse economic consequences of tariff (and non-tariff) carriers is overwhelming. Stigler says politicians--even if they won't admit it in public--know that aggregate welfare is reduced by tariffs, import quotas and the like. However, the local or regional benefits of protection are both clear and concentrated while the costs are quite widely diffused and--because they are largely opportunity costs--unseen by those that bear them.

The imperatives of politics often produces policies that diminish allocative efficiency because for politically effective groups there is more to be gained by redistributing income via government action than in gaining one's proportionate share of a more rapidly rising national income. While economists have been obsessed with economic efficiency of public policies, politicians (those who make the decision to intervene) are naturally concerned with gaining

and maintaining electoral support -- see Stanbury & Thain (1985). Hence they can continue to embrace a policy that is economically inefficient (reduces the nation's income below what it would be in the absence of the policy, all other things being equal), knowing it to be so. They do so, because it is politically efficient to do so (see Trebilcock et al., 1981, 1982).

5.0 AN OLD ISSUE

Discussion of normative bases of government action are as old as the idea of government itself.[2] For centuries such discussions were a staple in the work of philosophers.[3] One of the earliest analyses by an economist was that of Sir William Petty over 300 years ago. In his Treatise on Taxes published in 1662, Petty identified several "Public Charges of a State", that is, activities that should be performed by government. He lists the following responsibilities of the national government:

(i) "Charge of the Militia", i.e., "Defense of the State by Land and Sea, of its Peace at home and abroad, and also of its honourable vindication from the injuries of other States."

(ii) "Maintenance of the Governours, Chief and Subordinate" ... "in such a degree of plenty and splendour, as private Endeavours and Callings seldom reach unto..." In this category Petty included such offices as sheriffs, Justices of the Peace, Constables and Churchwardens. He also included in it both what we call the criminal justice system and the civil courts.

(iii) "Pastorage of men's Souls, and the guidance of their Consciences" ... The public support of religious institutions Petty justified in terms of the ease with which men may "elude the Laws of man, to commit unproveable crimes, to corrupt and divert Testimonies, to wrest the sense and meaning of the Laws... " He argued that "those who labour

in this public Service, must also be maintained in a proportionable splendour; and must withall have the means to allure men with some kinde of reward, even in this life..."

(iv) "Charge of Schools and Universities, especially for so much as they teach above Reading, Writing, and Arithmetick; these being of particular use to every man..." Petty was particularly concerned that such institutions supported wholly by "the Donations of particular men" would tend to select students "according to the fond conceits of their own Parents and Friends...rather [than] by the approbation of others more impartial..."

(v) "Maintenance of Orphans, found and exposed Children...[and] also of Impotents of all sorts, and moreover such as want employment." In other words, taxes should be levied to support orphans, indigent children and the unemployed. Petty held it "unjust to let any starve, when we think it just to limit the wages of the poor, so as they can lay up nothing against the time of their impotency and want of work."

(vi) "Charge of High-wayes, Navigable Rivers, Aquaeducts, Bridges, Havens and other things of universal good and concernment." Petty stated that these activities "may" be a "Publick Charge", suggesting he was less certain in a normative sense. One might argue that the items listed and the phrase "other things of universal good" foreshadows by more than two centuries the concept of public goods.

Even Adam Smith, the patron-saint of markets and advocate of the wonders of the "invisible hand," saw a not insignificant role for government in the economy. He offered the following normative bases of government action in 1776:

> The sovereign [i.e., the government] has only three duties to attend to; three duties of great importance, indeed, but plain and intelligible to common understandings: first, the duty of protecting the society from the violence and invasion of independent societies; secondly, the duty of

> protecting, as far as possible, every member of the society from the injustice or oppression of every other member of it, or the duty of establishing an exact administration of justice; and, thirdly, the duty of erecting and maintaining certain public works and certain public institutions, which it can never be for the interest of any individual, or small number of individuals, to erect and maintain, because the profit could never repay the expense to any individual or small number of individuals, though it may frequently do much more than repay it to a great society. (Bk. IV, Ch. 9, p. 311)

The task upon which we are engaged, then, is an old one made more important by the growth of government in the economy.

6.0 STRUCTURE OF THIS STUDY

Chapter 2 of this study focuses on the desire to improve economic efficiency in the allocation of our scarce resources by government action to eradicate or ameliorate the various market failures that reduce allocative efficiency. The second category of normative arguments are based on the idea that certain types of government action to alter the distribution of income or wealth or consumption opportunities will improve the welfare of society, as well as that of its direct beneficiaries. These arguments are discussed in Chapter 3. The third group of arguments for government intervention, which are discussed in Chapter 4, do not easily fit into either of the previous two classes -- which is not to say they don't have allocative or distributional consequences. Rather, they involve arguments for goverment action in order to create individual rights and thereby remove certain things from market processes. The list of references and bibliography are found at the end of the volume.

Notes to Chapter 1

1. The literature on various forms of government activity often speaks of the "rationales" for such activity. Yet this term is often used loosely to refer to a number of different things. For example, it is used to refer to both positive theories ("what is") and normatives bases ("what ought to be") of government action. The term rationale is also used to refer to the objectives of a piece of legislation (or public policy generally) and sometimes, to the forces that combined to bring about the policy. We try to avoid using the term rationale because of the confusion in its meaning. Our primary analytic distinction is between positive theories or explanations of acts of government intervention and the normative bases or arguments for such action.

2. Posner (1981, p. 144) notes that the origins of the state among primitive (pre-literate) men did not originate in the search for public order envisaged in the minimal or "nightwatch man" state. He continues,

> Two theories dominate current anthropological-historical speculation on the origins of the state. One emphasizes the role of the state in coordinating large-scale economic projects, such as irrigation; this is the 'hydraulic' theory of the state. The other emphasizes conquest and defense against attempted conquest as motivating factors.

3. Philosophically, the role of government in society has changed a great deal in the past two thousand years. For example, Viner (1960, p. 49) notes that "from the time of Classical Greece on, there was prevalent the doctrine that government was as 'natural' as the family or as society. Cicero held that government grew, or evolved by as 'natural' a process as did customs or mores ..." Viner (1960, p. 49) continues, "the counter-doctrine that government was a necessary evil arising out of the fall of man and original sin and having as its sole reason for existence the disciplining of sinful man, seems to have entered the mainstram of western thought with the advent of Christianity." Thomas Paine in his Common Sense remarked that "Society in every shape is a blessing, but government, even in its best state, is but a necessary evil ... Government, like dress, is the badge of lost innocence."

   Viner (1960, p. 56) points out that the 'mercantalists -- usually alleged to be the apostles of large-scale government intervention -- "would not dispute the general principle that the state should not interfere except where the public interest or the common good would best be served by interference." Yet, writing in the 1770s, Adam Smith was able to find the statute books overflowing with interventionist legislation. However, in the century before the publication of the Wealth of Nations (1776) and for several decades thereafter, the period was marked by slackness of enforcement, "by administrative nihilism ... [which was] deplored, not lauded." (Viner, 1960, p. 56).

   "As a general and systematically expounded doctrine, the doctrine of laissez-faire made its first appearance in the eighteenth century." (Viner, 1960, p. 47) Certain elements of this doctrine, however, can be found in much earlier times.

Chapter 2

GOVERNMENT ACTION TO IMPROVE ECONOMIC EFFICIENCY

> For four wicked centuries the world has dreamed this foolish dream of efficiency; and the end is not yet (George Bernard Shaw, John Bull's Other Island, Act IV).

1.0 INTRODUCTION

In this chapter I focus on the arguments for government action based on the desire to improve the efficiency with which society's scarce resources are allocated. The analysis of efficiency as the normative basis of intervention is based on the existence of several types of market failures that inhibit the achievement of Pareto optimality or the most efficient allocation of resources. The core of the argument is that governments can and should act to eradicate or ameliorate these market failures where the benefits of intervention are greater than the costs of the market failure to society.[1]

It should be emphasized that it is relatively easy to transform a normative argument for government action into a positive one or to transform a positive theory of government action into a normative argument. For example, instead of saying that where public goods, in a technical sense, occur governments should act to supply such goods because it will thereby increase allocative efficiency, one could offer a positive theory that asserts that where the market failure of public goods occurs governments will act to ensure their provision.

1.1 The Concept of Economic Efficiency

Intuitively, economic efficiency revolves around the idea of finding the "best allocation of resources" given our original endowments of resources, the

state of technology, and individual tastes and preferences. Economists use the Pareto criterion, which rules out interpersonal comparisons of utility or satisfaction, to compare alternative allocations of resources. An action to alter the allocation of resources (re-arrange inputs and/or outputs) is said to be Pareto efficient or Pareto preferred if it improves the welfare of at least one individual (in their own estimation), while not reducing the welfare of anyone else. Pareto optimality in the allocation of resources occurs when there exists no reallocation that is Pareto preferred. Any change in the allocation of resources from a Pareto optimal point would make at least one person worse off even though some other person(s) is(are) made better off. Therefore, when resources are allocated in a Pareto optimal fashion, there is no way of making anyone better off without making someone worse off.

It should be apparent that the Pareto criterion, while it has the virtue of ruling out interpersonal comparisons of utility, is not very helpful in the many situations where a change in the allocation of resources will make some people worse off while making others better off.[2] One attempt to deal with these situations is the Kaldor-Hicks criterion. It provides that a move from allocation A (e.g., the status quo) to allocation B is efficient if those who are better off in situation B are able to compensate those persons who are worse off in situation B and still have something left over. It is interesting to note that the supporters of this criterion do not require that compensation actually be paid, only that the "winners" are capable of compensating the "losers" and still be better off. For this reason, this attempt to extend the concept of efficiency has not had widespread appeal. There are also practical problems in getting possible winners and losers to reveal their true preferences for alternative allocations and in determining the amount of compensation they would be willing to pay or accept and feel they were no worse off.

Returning to the Pareto criterion, it should be emphasized that Pareto optimality (or "maximum efficiency in the allocation of resources") says nothing about whether the welfare of society is maximized. The reason this is so is that a Pareto optimal point exists for each set of original resource endowments and for each distribution of those endowments. The determination of a social welfare optimum requires not only that we identify the set of all Pareto optima, but that we construct a social welfare function that ranks (weights) the "deservingness" of the welfare of each each individual in society. See Bator (1957), Sen (1970), and Evans (1982).

Richard Posner (1981, p. 13), offers one of the strongest arguments for efficiency as a norm. He states that, "not only do I agree with Bentham that people are rational maximizers of their satisfactions in all areas of life, but I believe that economic efficiency is an ethical as well as scientific concept ..." However, in an effort to simplify and generalize the concept of efficiency Posner makes an error when he formulates the concept as "wealth maximization". Posner argues that "wealth maximization [not utility maximization] provides a foundation not only for a theory of rights and of remedies but the concept of law itself ..." (Posner, 1981, p. 74). Evans (1982, p. 464, n. 20) notes that in formulating the efficiency objective as wealth maximization, Posner is proposing the impossible because he has confused general and partial equilibrium. Evans points out that one cannot maximize W = P . X where P is a vector of exogenously determined prices and X is a vector of resource/output allocations, because in general equilibrium the P and X vectors are determined simultaneously and are interdependent, hence absolute prices have no meaning. "All one can define is an N-1 vector of price ratios for an arbitrary numeraire."

While economic efficiency may be immoderately embraced by economists (and some lawyers such as Posner), in general, it is little loved. The reasons are not hard to find. First, for most people allocative efficiency is an abstract concept beyond their understanding. This discussion of Pareto optimality, while done in non-technical terms, will probably strike most non-economists as abstract, if not irrelevant. Second, when efficiency is not an abstraction, for example, at the level of the individual workplace, it usually carries the connotation of producing more output in the same period of time by working harder. In the extreme, it has the connotation of "the speed up" on a production line or working in a "sweat shop" under a harsh task-master with the "reserve army of the unemployed" standing just outside the gates casting covetous eyes on every job inside. Third, where the concept of allocative efficiency is well understood, a rational, self-interested person will usually expend no effort to improve it. It is, in effect, a collective consumption good and that part of it that is individually appropriable (in expected value terms) will seldom be large enough to outweigh the expected costs of influencing a government to adopt policies that improve allocative efficiency. This point is discussed in section 2 on public goods.

1.2 The Concept of Market Failure

What do we mean by a market failure? We should begin with the concept of a market. A market is a social process in which prices are a "signalling system" to individuals acting in their roles as suppliers of inputs (capital, labour and materials) and as consumers who transform goods and services into utility or satisfaction. Markets are not moral institutions, but simply a means of coordinating human behaviour so as to allocate resources. There are or could be a variety of other mechanisms to perform the task of allocating resources. One has only to look to the Soviet Union and some of its allies to see the

centrally-planned, command system of allocation in operation over the major part of their economies. The price system, however, has considerable aesthetic appeal operating as it does on a highly decentralized basis by means of the "invisible hand". As Evans (1982, p. 460) notes, "under specific circumstances, the price system both conveys information and generates incentives to govern the behaviour of transactors in a detailed and sensitive way." Markets cannot do everything, however, in terms of maximizing social welfare. The distribution of income resulting from the most efficient market processes still depends largely upon the distribution of original endowments. Moreover, the market-determined distribution of income (and consumption opportunities) may not be in accord with widely-held views of who should get what. This issue is addressed in Chapter 3. Furthermore, market failures may be present. These are exogenously determined impediments to Pareto optimality i.e., the efficient allocation of resourcs.

To understand market failures we need to identify the background assumptions in the neoclassical model. First, it assumes that the well-being of the individual is the appropriate focus of the analysis. Second, the model assumes that society's welfare is no more than the welfare of its members. Third, it is assumed that individuals are always the best judges of their own welfare. Fourth, it is assumed that an individual's welfare does not depend on the welfare of others.

One of the core propositions of welfare economics that emerges is that an economy composed of perfectly competitive markets will produce a Pareto-optimal allocation of resources. In other words, economic efficiency will be maximized. Davis and Kamien (1970, p. 74) put the point this way:

> Given certain assumptions about the technology, the availability of information, the characteristics of goods and services, and the absence of monopoly power, there exists a set of market prices which, responded to by profit-maximizing firms and utility maximizing consumers, will result in the attainment of a Pareto optimum position for the economic system.

The necessary assumptions are as follows:

- technology: all firms have convex possibility sets, that is, there cannot be increasing returns to scale.
- information: producers have complete knowledge about the available technology and all relevant prices; consumers are assumed to know whether goods and services are available, their characteristics, and their prices.
- characteristics of goods and services: there are no public goods, only private goods. There are no non-pecuniary externalities -- but "the presence of externalities is not sufficient cause for the market to avoid optimality" (David & Kamien, 1970, p. 77).
- absence of market power: it is competitive markets that are capable of achieving Pareto optimality, not ones in which firms have some market power.
- universality of markets: it is assumed that markets exist (or can be brought about) for all of the items that enter into a firm's production function or an individual's utility function.

Note that nothing is explicitly stated in the list of assumptions concerning transaction costs.[3] However, Arrow's (1970, p. 68) formulation of the "universality of markets" assumption implies that the presence of high transaction costs may prevent the existence of certain markets. The point is ambiguous and it is discussed in section 8 of this chapter.

It is obvious that in very few markets in the real world do these conditions hold. Market failures, in some degree, are common, although competition may still be "workable".[4]

It is useful to make distinctions between three types of alleged "market failures".

(i) Technological or True Market Failures

This category consists of true market failures which are exogenous to the economic actors in the marketplace. They are not created by government action nor by buyers or sellers. In short, they exist in nature, although government action may ameliorate such failures. Included in this category are the following types of market failures: public goods, imperfect information, externalities, the absence of individual property rights (this is really a form of institutional failure in the assignment of property rights), and increasing returns to scale including the case of natural monopoly.

(ii) "Man-made" Market Failures

This form of market failure is not exogenous or given in nature as in category (i). These are not true market failures. Rather buyers or sellers act jointly or individually to restrict competition in such ways as the following: price fixing/market sharing agreements, i.e., cartelization; restrictions on entry into the industry; and predatory pricing. To be successful these last two activities require structural market power.[5] These restraints on trade are the object of competition policy legislation.[6]

(iii) Government-created Constraints on Allocative Efficiency

Governments seldom act consciously to reduce allocative efficiency, but in the name of achieving other objectives, such as altering the distribution of income, they frequently impose constraints on markets that make them allocate resources inefficiently according to the Pareto criterion. While allocative efficiency may be good for society as a whole, highly competitive markets produce distributional outcomes that find little acceptance, particularly by the "losers". Not surprisingly, they seek the assistance of government in constraining market forces so as to alter "who gets what". See Trebilcock et al. (1982). The recent explosion of research in Canada and the United States on government regulation makes it clear that, despite the rhetoric, governments

regulate most frequently to alter the distribution of income.[7] Consider the case of government-mandated, agricultural products supply management schemes. They have been instituted to increase farmers' incomes by restricting output and thereby increase the prices paid by consumers. They certainly do this, but they also impose large efficiency losses. Lermer and Stanbury (1985) estimate that these losses amount to between $3 and $9 for each dollar transferred from consumers to farmers.

But even where regulation, for example, is apparently designed to remedy a market failure, it often inhibits efficiency as a by-product. For example, the regulation of automobile emissions in the U.S. (a response to the market failure of externalities) had the effect of increasing the consumption of gasoline. Zoning controls, also designed to deal with externalities in the use of real property, may substantially increase the cost of housing. In both of these cases, the problem lies more with the specific way in which government intervened, rather than the principle of intervention itself. But the point remains, government action to "do good" in one area often produces fairly predictable adverse impacts on allocative efficiency.

In the remainder of this chapter we focus on true market failures.

2.0 PUBLIC GOODS

2.1 The Concept

Public goods, in the technical sense as the term is used in the literature of public finance and welfare economics, are collective consumption goods for which each individual's benefit--unlike the case with private goods -- leads to no subtraction in the total benefits available for others. Perhaps the classic example of a public good is national defence. The benefits you receive from the nation's defence system in no way reduces the benefits I am able to derive from it. Alt and Chrystal (1983, p. 177) argue that the "key characteristic of

public goods is that, for any total amount supplied, the benefit received by one individual does not affect the benefit [or disbenefit] available to another individual." This stands in contrast to private goods in which consumption by individual A reduces the amount available for everyone else. Samuelson (1969, p. 102), in his later formulation of the problem, describes the characteristics of public goods more generally: a public good is "simply one with the property of involving a 'consumption externality,' in the sense of entering into two or more persons' preference functions simultaneously". He emphasizes that the subjective enjoyment of the same public good may be positive for some and even negative for others. For example, a wealthy person may derive great enjoyment from the protections afforded her by the criminal justice system, while "second story artists" certainly hate it. Dorfman (1969, pp. 248-50) stresses the free rider/non-excludability aspects of public goods. He notes they are "enjoyed," but not "consumed"; that there may not even be a definable act of consumption; and that the benefit can be derived without any act of appropriation. He notes that, "since none can be precluded from enjoying them, it is in the interests of each to avoid contributing to them if he can." Therefore the coercive power of the state is necessary to compel contributions.

Samuelson (1969, p. 105, n. 2) stresses that non-excludability is less important than the consumption externality (external effects or 'neighbourhood effects') aspect of public goods: "The possibility or impossibility to apply 'an exclusion principle' is less crucial than consumption externality, since often exclusion would be wrong where possible. 'Joint consumption' is not an apt name for consumption externality."[8]

Musgrave (1969, p. 124) uses the term "social goods" which he takes to be "those which require group action to secure their provision in line with individual preferences. He states that their essential characteristics are

- non-rivalness in consumption (or beneficial consumption externalities), hence we add demand curves vertically for social goods rather than horizontally for private goods; and

- non-excludability from consumption--hence people unwilling to reveal their true preferences by market behaviour; we have to use voting.[9]

2.2 The Significance of Public Goods

While the concept of public goods flourished in the Italian, German and Scandinavian literature[10] on the theory of public expenditure in the late nineteenth century, its development in English-speaking countries is attributable to Pigou (1932) and Samuelson (1954, 1955, 1958, 1969). The latter was able to show algebraically and geometrically that where public goods exist, Pareto optimality cannot be achieved because equality between marginal rates of substitution and marginal rates of transformation no longer holds. The crux of the problem is that "no decentralized pricing system can serve to determine optimally these levels of collective consumption" (Samuelson, 1954, p. 388). Moreover, it is not possible to create the necessary complex multiple pricing structure to determine the optimal amount of public goods because each person has an incentive to give false signals about his true preferences (willingness to pay) for such goods. Therefore, one of the proper functions of government is to make adequate provisions for public goods[11] and so improve allocative efficiency.

2.3 Comparing Public and Private Goods

It is necessary to expand on the characteristics of public goods and one useful approach is to compare and contrast public goods and the more familiar private goods. This is done in Figure 2-1. As can be seen, the critical characteristics of public goods are that they are

- only enjoyable collectively,[12]

- subject to external economies in consumption,

- subject to "free riders" because it is inefficient or impossible to exclude those who do not pay for such goods,

Figure 2-1

Comparing Public and Private Goods

Characteristic	Private Goods	Public Goods
• Appropriability	• Appropriable by individuals who reveal their preferences by their willingness to pay the market price.	• Can only be enjoyed collectively, although the benefits received may vary greatly across individuals.
• External economies in consumption	• None--at any moment in time consumption of some of a private good reduces the amount available to be consumed by others.	• There are external economies in consumption as consumption by one individual does not reduce the amount of the public good available to others. (In some cases, this applies only up to some capacity limit, e.g., a road or a bridge.)
• "Excludability"	• It is efficient and acceptable to exclude from consumption those who fail to pay the market price. There are no "free riders."	• Once the public good is in existence, it is inefficient or practically impossible to exclude people from obtaining its benefits even if they have not contributed to its cost of production.
• "Jointness in supply"	• Production may be subject to some economies of scale, but the creation of a unit of private goods does not make it available to all without additional cost.	• Subject to a special form large scale "lumpiness" or "indivisibilities" in production. Once produced, any given unit of good can be made equally available to all. Extension of the supply to one facilitates extension to all.
• Incentives to reveal true preferences	• Because of excludability, individual appropriability and no free riders, each individual has an incentive to reveal his preferences in the form of his willingness to pay for specific goods and services. Collectively, the "dollar votes" of consumers determine what will be produced and in what quantities, given the supply function.	• Individuals have an incentive to understate their true preferences as they can "free ride" once a public good is in existence. They can't be excluded, or it is inefficient to do so.
• Are Pareto optimal quantities produced in response to decentralized market signals?	• Yes, where competitive market conditions prevail and there are no market failures. Where market failures occur or market power exists Pareto optimality is unlikely to be achieved.	• No, because of the characteristics outlined above, in the absence of government intervention the supply of public goods will be less than Pareto optimal.

- subject to jointness in supply -- once they are produced any given unit of the good can be made equally available to all (or at least to numbers of people); and

- subject to a disincentive for individuals to reveal their true preferences for them.

Economists frequently cite a lighthouse as a classic example of a pure public good. All those within its range can benefit from its services without reducing the value of its services available for others. Once the lighthouse is operating it is available for all and no one can be excluded from its use. Those who did not help to finance its cost can be "free riders". If fishermen or other seafarers are asked how much they want a lighthouse each has an incentive to understate his true preferences because, if someone else pays for its construction, he can use it without cost. This fact means that unless the expected benefits to one shipowner exceed the costs of the lighthouse (and the present value of its operating costs), it is very unlikely to be built.[13] This is true even though the aggregate expected benefits to all seafarers (or the owners of ships) would greatly exceed the costs of building and maintaining the lighthouse. Because only a government has the legal power of coercion (e.g., to tax), it will be necessary to ensure that this public good is built. (If a few owners jointly agree to finance a lighthouse, the social pressure of their exchange of promises may well be sufficient to see that a lighthouse gets built.)

With modern technology, lighthouses no longer need be public goods. A private entrepreneur could build a radio beacon tower and sell to seafarers electronic devices to decode a signal that would tell them how far they are from the rocky shore. This form of "lighthouse services" is now an individually appropriable, excludable private good for which there are no external economies in consumption, although there is some "lumpiness" in production, i.e., the tower and transmitter must be built and powered even if only one decoder is sold.

2.4 The Extent of Public Goods

Page (1983, p. 102) estimates that public goods account for one-half the United States' federal budget.[14] This high estimate stems from his overly broad definition of the concept of public goods. There is likely to be little disagreement over Page's (1983, p. 123) argument that law and order is "a classic public good".

> When a criminal is caught or deterred, all potential victims benefit; it is not easy to demand a fee for the service and exclude from protection those who won't pay. There are also economies of scale in providing law and order over a broad geographical area rather than turning particular shops or houses into security zones. Once again, private markets left to themselves would underprovide the good. Only large firms and wealthy individuals could afford private guards in the absence of courts and policemen.

However, he goes much too far when he argues that

> Mass transit is a more clear case of a public good [compared to natural resources and the environment]. Since automobiles produce public bads of pollution and noise and congestion, which drivers generally escape paying for, cleaner and more compact buses and subways provide social benefits not reflected in the prices that riders are willing to pay. Subsidies for mass transit (or high taxes on trucks and autos) make sense (Page, 1983, pp. 129-130).

There are, in reality, very few pure public goods[15] (e.g., national defense), but there are quite a number of goods or services which have "public good characteristics". Consider the case of roads or bridges. These are public goods subject to conjestion or negative externalities in consumption. Once they are built it is inefficient, but not impracticable, to charge more than their marginal cost of supply. When there is excess capacity marginal cost is virtually zero--the additional maintenance of one more vehicle less than the allowable weight limit is minute, probably not worth collecting at a toll booth. As congestion increases on a road or bridge, however, economic efficiency requires that the service be priced to equate the marginal social costs (which have risen as the drivers' costs have increased due to the slowing of traffic) and benefits of the transportation infrastructure.

It should be noted that intangible services can be public goods (or have several of their characteristics). Consider the case of legislation that creates an effective competition policy, i.e., where restraints of trade that inhibit the efficient allocation of resources are prevented or reduced to a minimum. The benefits of such a policy--improved allocative efficiency resulting in a larger national income[16]--are widely diffused, but are not individually appropriable. No one can be excluded from the benefits of the policy and there are externalities in consumption, i.e., one individual's enjoyment or "consumption" of the benefits of the policy in no way reduces the amount available for all. Moreover, once the policy is produced it is available for all--although the characteristics of the policy itself may be varied considerably.

The costs of the policy are seen to take two forms. First, there are the true social costs of administering and enforcing the law--whether by private or by public action. Second, there are the purely pecuniary costs to firms that had benefitted from or would be able to benefit from the imposition of restraints of trade--for example, a price fixing cartel whereby prices are increased at the expense of buyers. While shareholders are better off, the buyers of the product or service are worse off. Whether this redistribution of income is desirable or undesirable is a value judgement. In any event, there is a true social cost in the form of a misallocation of resources, which occurs as a result of the cartel's actions to restrict ouput below the competitive level in order to raise price.[17] If the cartel is allowed to flourish, the level of output in that industry will be "too small", i.e, allocative efficiency would be increased if output was increased to the level that would occur under perfect competition.

Head (1962, p. 218) extends this type of analysis to other types of public policies and concludes that "in a broad but very real and important

sense...domestic and international stability, domestic and international allocation of resources in accordance with consumers' wishes and an optimal rate of growth can all quite properly be regarded as public goods, for adequate provision of which public policy must be relied upon."

In considering the case for government intervention on grounds of public goods one must be careful not to overgeneralize the case. There are a large number of goods or services that, for example, have some external economies in consumption. A private park that can be over looked by apartment dwellers some distance away who did not share in the cost of its creation is one. A new, private building that revitalizes an old neighbourhood is another. The owner almost certainly cannot capture all of the benefits attributable to his building, although he may, in turn, benefit (e.g., higher rents) from the other new buildings that are built nearby.

Second, the production of many goods or services are subject to "lumpiness" or "indivisibilities" in supply in the sense that substantial economies of scale exist over a range of output that constitutes a substantial share of the market. For example, an efficient cable television operation may require both a substantial absolute number of subscribers and that a fairly high "penetration rate" be achieved. The latter condition means that a substantial fraction of the households along the routes where the cable has been installed (usually on telephone poles) sign up for the service. The former requirement is a result of the large fixed costs of the "head end" unit to receive and amplify the television signals. In this case, while there are some indivisibilities in production/supply, there are no external economies in consumption and the service is individually appropriable and non-payers can easily and efficiently be excluded. Therefore, the supply of cable television services is not a public good.

It should be emphasized that there are very few pure public goods as Head's (1962) analysis reveals. For example, regarding the jointness in supply attribute, he points out that

> "Capacity limits" are usually met well before the good has become equally available to all, thus applying alike to roads, bridges, hospitals, courts, police, and even flood control measures, irrigation, nation-defense, and public health schemes such as vaccination programmes and draining of malarial swamps. Furthermore, even before capacity limits in any strict sense are encountered, quality variations usually occur. Crowded roads are other facilities that are usually regarded as giving inferior service to that provided by the same "goods" less fully utilized (Head, 1962, p. 201).

In general terms, the concept of public goods is quite closely related to several other types of market failure: externalities, increasing returns to scale, and failure in the assignment of property rights. Nevertheless, it remains an important normative basis for government intervention.

3.0 EXTERNALITIES

3.1 The Basic Concept

In general terms externalities, or external effects, or "neighbourhood effects," or "spillovers" may be either beneficial or harmful effects stemming from an economic process that fall upon a third party, i.e., someone who is not a party to an economic transaction. The most obvious example of a negative externality is that of pollution. A steel mill produces black smoke as a by-product of making steel. The smoke dirties the wash on clotheslines near the plant; it helps to create smog; and it increases the frequency with which buildings and windows must be cleaned. In short, not all of the costs of making steel are being reflected in the steel company's books.

In Pigou's (1932) terminology, we say that when an externality is present there is a divergence between private costs and social costs (the total costs of society of producing a good or service). Dahlman (1979, p. 141) interprets this

to mean that "when all voluntary contractual arrangements have been entered into by market transactors, there still remain some interactions that ought to be internalized but which the market forces left to themselves cannot cope with." Why is this so? Dahlman (1979, pp. 141-142) argues that "the only reason why wealth-maximizing economic agents do not undertake these transactions must be that the cost of carrying out the actual transaction is greater than the expected benefit." In other words, in the absence of transaction costs there would be no Pareto-relevant externalities. This point will be discussed below and in section 8 of this chapter.

Bator (1958) suggests there are four types of externalities:

(i) Interdependencies between producer/consumer/factors of production that are external to the price system. These involve outputs that are non-appropriable. The standard example is pollution--because individuals do not have property rights in the air or water, producers do not incur costs for their use in the disposal of wastes. In this case, private costs are less than social costs. Generally, see Coase (1960) and Dahlman (1979).

(ii) Ownership Externalities: This is the "unpaid factor" case where scarcity is divorced from effective ownership. This may be due to "common pool" effects or to high transaction costs.

(iii) Technical Externalities: This case occurs where we find large scale indivisibilities or smooth increasing returns (decreasing unit costs). The result is that there are "uncompensated services," but appropriability as such is not the problem, e.g., a private individual can own a bridge but the optimal toll is zero (up to capacity) for that is the marginal social cost once the bridge is built.

(iv) Public Goods: This is the case of externalities in consumption whereby the consumption by one individual in no way reduces the amount available to others. Recall the discussion in section 2 above.

In each case allocative efficiency may be improved by government actions to realign and internalize private and social costs and private and social benefits.[18]

3.2 Characteristics of Externalities

I shall now discuss the important characteristics of externalities as a market failure. First, there is a disparity between private and social costs, and between private and social benefits. As a result, too much of some goods/services are being produced (ones for which private benefits exceed social benefits or private costs are less than social costs) while others are being produced in too small a quantity. "Too much" and "too small" are used in the sense that the resulting allocation of resources is not Pareto optimal which requires that the costs and benefits facing each actor are the full costs and benefits to society. In other words, at least one person in the economy can be made better off without reducing the economic welfare of any other person by rearranging inputs and outputs.

Second, by definition, external effects either confer benefits or impose costs of persons (or organizations) that are not participating in the economic process that produces them. For example, consider a pulp mill that produces a toxic effluent as a by product of making pulp and this effluent is discharged into a stream. As a result, fishermen, who neither supply an input or buy the output of the mill, find that fish stocks are reduced by the effluent. Their incomes fall, hence they are worse off as a result of the negative externality (pulp mill effluent). The market value of the fish killed is a social cost, but the pulp mill does not compensate those who bear these costs, nor are these costs incorporated into its cost function.

Third, externalities amount to a failure to internalize all of the relevant consequences (good and bad) of an economic actor's decisions. In the pulp mill example, the mill pollutes the stream because it is cheaper to dispose of its

wastes in that fashion than in some other (e.g., better abatement controls such as settling ponds and landfill) that may have less adverse consequences for others. In short, it is not paying all of the social costs of producing pulp--which include waste control/management costs. If a tax were imposed on the effluent now discharged into the stream that reflected the full social costs of pollution, the firm would very likely reduce the amount of pollution it produces.[19]

Fourth, externalities refer to real (physical and technological) effects that create changes in the allocation of resources not merely to the pecuniary or income distribution effects of an action that produces an economic impact on third parties. True externalities also have distributional consequencs, but it is the efficiency consequences that are the focus of the market failure problem.

Fifth, externalities may be either positive or negative, and may be uni- or bi-directional. For example, economists frequently refer to the case of a bee keeper locating adjacent to an orchard as one of "mutually reinforcing positive externalities."

Sixth, externalities may be generated by governments as well as private sector actors. In the Soviet Union state-owned plants have seriously polluted Lake Baikal, one of the most magnificent fresh water bodies in the world.

3.3 Externalities and Property Rights

The heart of the problem of externalities appears to lie in a failure in the assignment of property rights, most notably in the case of common property resources--those which are owned collectively rather than individually.[20] Anderson and Hill (1980, pp. 5-6) explain,

> To ensure that voluntary actions of individuals are productive, ownership must be exclusive. Property rights cannot be attenuated without incurring a social cost. For ownership to be exclusive, rights governing the use of resources must be well defined, enforced and transferable ... Whenever ownership is nonexclusive, the link between authority and responsibility is broken. When this occurs, the positive sum actions of individuals do not necessarily result in productive activity for society.

A specific example of externalities and common property resources is that of a pulp mill. The mill pollutes the river next to it where the river is owned by all of us, i.e., it is Crown property. However, none of us has a direct interest in asserting our right to prevent the destruction in the value of our property which includes the value of the fish that inhabit it.[21] Air and water pollution amount to the "inventorying" of wastes for free in "warehouses" that are owned by everyone (the atmosphere, and rivers, lakes and oceans), but effectively controlled by no individual. If the pulp mill sought to dump its effluent on the privately-owned land adjacent to it, the owner would sue for damages and an injunction to prevent any future dumping on his land.

Some of the important implications of the absence of individual property in the production of externalities were developed by Coase (1960). He formulated what is now known as the "Coase Theorem": where there are uncompensated social costs, the allocation of resources can be improved by the assignment of liability (property rights) to either the emitter of the negative externality (i.e., a polluting pulp mill) or to the recipient of that externality who now bears its cost.

To use our pulp mill example, if there was no toxic effluent there would be no poisoned fish. If there was no fishermen in the stream or stream adjacent to the mill, there would be no loss from poisoned fish. Therefore, if the pulp mill was made liable for its negative externalities--which is the same as stating that fishermen have a right to enjoy unpolluted streams--then the mill would, Coase argues, compensate the fishermen for damages, pay them to move and fish elsewhere, or agree to bear the cost of abatement in lieu of the other alternatives. Alternatively, the fishermen could be held liable, i.e., the mill is assigned the right to pollute the stream. In this case, the fishermen would be willing to pay the mill to install abatement equipment to prevent the poisoning of the fish if the net value of the fish caught exceeded the cost of

the abatement equipment. Coase argues that regardless of the initial assignment of liability the parties will bargain until they exhaust all the "gains from trade" and "the outcome of the subsequent bargaining will be that which maximizes the value of output."

Three important points should be noted about Coase's "solution" to the externality problem. First, it ignores the transaction costs involved in bargaining a solution once property rights have been assigned to individuals, presumably by the state.[22] In fact, Dahlman (1979, p. 142) argues that "transaction costs are ... a necessary condition for the persistence of unwanted effects from externalities, for with zero transaction costs side effects will be internalized and will not negatively affect resource allocation. ... In the theory of externalities, transaction costs are the root of all evil." See also Calabresi (1968). In other words, another possible form of market failure underlies this widely-cited example of a market failure - see section 8.

Second, Coase assumes there are no constraints on the bargaining of an efficient solution and that a government will exist to resolve conflicts over which the private parties are deadlocked. In reality we know that people are highly averse to losses and they exhibit a remarkable reluctance to trade - see Knetsch et al. (1984). There is a wide discrepancy between what people are willing to pay to obtain some benefit and the amount of money they require to compensate them for giving up something they now possess and regard as part of their holdings. In the case of air pollution, if the factory is given the "right to pollute," it is unlikely that nearby residents will be willing to pay very much to have the factory abate its emissions or move elsewhere. If the residents have the "right to clean air," and this right is transferred to the factory, the compensation demanded by the residents will be much greater than what they would be willing to pay the factory to reduce or eliminate its emissions.

Third, Coase ignores the distributional implications of who is assigned the right to pollute or the right to enjoy clear air/water. For some people, these outweigh efficiency considerations.[23]

3.4 Alternative Government Actions

If the objective of government intervention is to improve efficiency, what alternatives does it have--assuming that the costs of intervention are less than those of the externality? The following governing instruments may be used

- assignment of property rights to individuals in what are now common property resources--such rights may be assumed by the government itself as if it was a private owner;
- regulation--for example in the form of constraints on the levels of pollutants that may be emitted, noise that is made or types of uses that land is put to;
- the imposition of taxes and/or subsidies to internalize externalities and assign private and social costs and benefits (economists usually argue that this alternative is more efficient than the more commonly adopted one of regulation); and
- public ownership of those entities that are the largest generators of negative externalities (e.g., if Inco can't be regulated, Ontario or the federal government could acquire it and spend the money necessary to greatly reduce SO_2 emmisions).

More generally, see the useful discussion in Davis and Kamien (1970, pp. 85-94).

4.0 IMPERFECT COMPETITION AND MARKET POWER

4.1 Significance of Imperfect Competition

As we have noted, one of the most important theorems of welfare economics holds that if all markets are perfectly competitive (and certain other fairly highly restrictive assumptions hold), the resulting allocation of resources will be Pareto optimal. But in the real world, most markets are not perfectly competitive. Specifically, the number of firms is seldom so great that each acts independently of each other and operate as price takers. Products or services are seldom perfectly homogenous. Rather, some degree of product differentiation is the rule. Where the number of competitors is few -- the

extreme being the case of monopoly or single seller -- firms will possess some degree of market power. They will have the ability to restrict output and raise price above that which would prevail under perfect competition. As a result, the allocation of resources will not be Pareto optimal.

Note that if economies of scale (increasing returns) are important in an industry, the "natural" market structure may be an oligopoly. Therefore, the leading firms will have a degree of market power, i.e., discretion over price and output. Firms will be interdependent. They will not be able to act independently of each other. In this case, their market power is attributable to a market failure (increasing returns to scale over a considerable range of the long run cost curve).

However, an oligopolistic market structure may not be attributable to economies of scale, yet the firms may seek to collude on price and/or output thereby producing an allocatively less efficient outcome. The conditions of entry are of particular significance in determining the ability of firms in an oligopoly to act on the recognition of their mutual dependence. If entry is relatively easy, then the industry price and output is likely to differ little from that which would occur if the industry had many competitors.

While oligopoly is the most common form of market structure in Western economies, and particularly in Canada which has a small domestic market, the strongest case for intervening on efficiency grounds in the face of market power is that of "natural monopoly".

4.2 The Case of Natural Monopoly

The essence of the traditional concept of natural monopoly is that economies of scale (increasing returns to scale) are sufficient that average total costs (and marginal costs) are declining in the range that the market demand curve intersects the average cost curve. Put another way, the total (and unit) costs of supplying the market demand will be lower if a single firm

produces all the output -- see Schmalensee (1979). In the absence of collusion and interference by the state, industries characterized as natural monopolies will usually result in a single firm producing all the output even if more firms once occupied the industry. This is so because a single firm can produce all the output the market demands at lower cost than can two or more firms.

Government intervention in the form of regulation is necessary, it is argued, for two reasons: first, to prevent the monopolist from exploiting consumers by raising his price above average total cost (including a normal return on capital) by restricting output. The result would be "excess" profits or economic rent for the firm. This is the most common argument for the regulation of monopolies, "natural" or otherwise. In terms of our classification of the normative bases of government intervention it should be grouped under the arguments concerned with altering the distribution of income -- or of preventing changes in the distribution of income or wealth. See Chapter 3 below.

Second, economists emphasize that the monopolist in restricting output and raising price generates allocative inefficiency in that less than the socially optimal amount of output is produced. At its simplest, allocative efficiency requires throughout the economy the additional output be produced until its marginal social value (as reflected in the demand curve) just equals the marginal social cost of production. In the case of a monopolist, at the profit maximizing output, the social value of additional units is greater than their cost. Too little is being produced. The allocation of resources is not Pareto optimal. (This is true in general of oligopolies where firms are able to exercise some degree of market power and restrict output below the competitive level.)

Therefore, it is argued that allocative efficiency can be improved by government regulating the sole supplier in the case of a natural monopoly. This

usually takes the form of government controls over entry (why they are necessary if we have a true single-product natural monopoly is not explained -- see Demsetz, 1968b), and over the price the firm charges for its output. In theory, price should be set by the regulator so as to equate marginal cost and marginal revenue. However, at this socially ideal point the firm will lose money (fail to earn a normal return on its capital) as its average total cost (ATC) will be below its average revenue. The practical solution is for the regulator to set price such that ATC=AR (per unit) where ATC includes a "fair and reasonable" return on its invested capital. In skeletal form, such is the normative case for government regulation of natural monopolies. The efficacy of such regulation has been widely criticized (e.g., Kahn, 1971). The need for it on efficiency grounds has also been challenged. See Demsetz (1968b) and Posner (1969).

4.3 Is It Necessary to Regulate Natural Monopolies?

Demsetz (1968b, p. 56) argues traditional natural monopoly theory is deficient "for it fails to reveal the logical steps that carry it from scale economies in production to monopoly price in the market place." The essence of his position is that "the existence of scale economies in the production of a service is irrelevant to the determination of the number of rival bidders [and that] the lowest price need not be a monopoly price" (Demsetz, 1968b, p. 57). This idea is not new, Demsetz is able to find an article published in 1859 by Chadwick which draws the distinction.

The crucial assumptions for Demsetz's (1968b, p. 58) scheme to work are as follows: (i) "The inputs required to enter production must be available to potential bidders at prices determined in open markets. This lends credibility to numerous rival bids. (ii) The cost of colluding by bidding rivals must be prohibitively high." Demsetz notes these are no different from those required to avoid monopoly price in any market and that if collusion of bidders is easy,

it is probably similarly easy for buyers. A lengthier critique of the rationale for regulating natural monopolies is given by Posner (1969).

4.4 Economies of Scale and Scope

It is now widely recognized that there are very few natural monopolies in the sense of a single firm producing a single perfectly homogeneous product using a single production technology, aside from those that have been created for the administrative convenience of the regulators. Most regulated firms, indeed most large firms, employ multiple technologies to produce multiple outputs for sale in highly differentiated markets. Furthermore, where product attributes are held constant, many firms face decreasing costs where the volume of output is increasing. However, this fact is not necessarily evidence of chronic market failure--hence a legitimate basis for economic regulation.

Economies of scale refers to the behaviour of unit costs as output increases in the case of a single output. Economies of scope, on the other hand, refers to the circumstances where the total cost of a multi-output firm (for a given level and mix of output) are lower than the total costs of those same outputs produced independently.[25] Put another way, economies of scope recognize that a firm's capital and labour are capable of producing a variety of different goods or services at a lower cost than they could be produced by a number of specialized firms. Generally, see Bailey and Friedlaender (1982).

Under certain rather restricted conditions, it can be demonstrated that an unregulated market made up of firms with multi-input, multi-output firms will support the optimal number of firms, producing the optimal product mix at optimal quantity levels and prices (Baumol, Bailey and Willig, 1977). Furthermore, this conclusion holds where non-decreasing returns to scale and production complementaries are strong enough to confer cost advantages to single firm production of the optimal product mix. In this instance, only the optimal

set of prices (Ramsey prices) and goods and services can guarantee a natural monopoly against competitive entry. Generally, see Willig (1979).

One implication of this perspective is that there is no reason to believe, based upon the logic of market failure, that price controls are appropriate on economic grounds to industries such as telecommunications or the postal service (so-called natural monopolies), but not to the automotive industry or the soap industry. The second implication is that, in any industry with these characteristics, some firms and some consumers stand to gain from regulation at the expense of their fellows. Prices can be manipulated to benefit some consumers to the detriment of others and product differentiation suppressed, thereby reducing "unit" costs in the industry to the detriment of those firms seeking to exploit fully existing product/market opportunities. While Peltzman (1976) concentrates his attention on the first of these possibilities, cross-subsidization, the conclusions one might draw with respect to the second are identical. More generally, see the discussion in Stanbury and Thain (1985).

5.0 "DESTRUCTIVE COMPETITION"

In this case, in contrast to natural monopoly, economies of scale are unimportant--"competition is the natural state" (Kahn, 1971, p. 172). It is the very intensity of competition which, it is argued, has to be the subject of economic regulation to protect the quality of service.

The core of the issue with destructive competition is the idea that, due to certain structural conditions, an industry (not just some firms in the industry) could earn only sub-normal profits in the long run. This would not occur under normal conditions because persistent sub-normal profits would act as a signal for the less efficient firms to leave the industry. Where competition is truly destructive, this does not occur, or if it does, new firms enter the industry even though the firms in the industry are performing poorly.

Recently, the new president of Air Canada, Pierre Jeanniot, argued that direct regulation of the Canadian airline industry by the Canadian Transport Commission should be continued in order to prevent destructive competition.[26] Jeanniot's view of destructive competition can be summarized as follows:

> (i) [there will be] predatory pricing in the face of excess capacity; (ii) oligopolists compete so as to 'destroy their financial substance' by failing to cover total costs in part because they are trapped in a 'prisoner's dilemma' situation; and (iii) waves of new entrants, in the absence of regulatory barriers, produce a persistently unstable and unprofitable industry.

Jeanniot indicated that the following will be the effects of destructive competition: (i) reduced standards of quality of service; (ii) failure by the airlines to acquire new equipment embodying the latest technology; (iii) temporary reductions in costs and fares; (iv) persistent subnormal profits; and (v) bankruptcy for at lease some firms. The fundamental problem appears to lie in what is meant by the term "destructive competition".[27]

What are the structural conditions that could produce a case of destructive competition and prevent an industry from attaining a long run equilibrium in which normal profits are being earned? According to Kahn (1971), the prerequisites of destructive competition are the following:

- fixed costs must be a large proportion of total costs;
- there must be long-sustained and recurrent periods of excess capacity (this will be exacerbated by the fact that physical capital is long-lived and the exit of factors of production is slow); and
- the number of competitors must be so large that producers cannot coordinate their efforts to restrict output and raise price. (As a result, economies of scale cannot be important in the industry.)

Therefore, marginal cost may be below average total cost for significant periods of time. Historically, the record is one of instability of prices and producer

incomes in both the long and short run. Output (or supply) elasticity is low, but shifts in demand can be significant. Supply is inelastic down to each firm's out-of-pocket costs. The industry is "sick" in periods of low demand as most firms in it are failing to earn normal returns.

But how do these circumstances impose a threat to the welfare of the industry's customers, the ostensible beneficiaries of government regulation? The following arguments are offered. First, postponable maintenance and repair expenditures may be curtailed. The problem here is one of imperfections in the capital markets -- and also the slow speed with which real capital can be redeployed to more profitable uses, i.e., it is long-lived once committed to a particular use and/or it is specialized and cannot be transferred to other uses. Second, risk averse consumers may not find fluctuating prices attractive. Fluctuations make long term business planning more difficult. Therefore, pervasive uncertainty may lead to inefficiency. Third, consumers may have difficulty in judging product/service quality even with many sellers. Important characteristics include: physical specifications, reliability, frequency, financial responsibility of sellers--particularly in utility services. It is argued that severe price competition puts pressure on safety, reliability and frequency. "Cheating" on quality may be a "way out" for firms under extreme competitive pressures.

But does it follow that price and entry controls are the only (or the best) way to cope with these imperfections? Administratively, it may be easier to enforce quality standards. There are fewer sellers to inspect, cross subsidization may be used to provide higher quality, and the possible loss of a valuable license may be used as a threat by the regulators in order to achieve the desired quality standards.

Since the possibility of "destructive" or "excessive" - competition can occur, although it is rare in the real world, Kahn (1971, p. 178) says we should ask three questions in such cases:

> (1) to what extent those circumstances actually prevail or would prevail if controls were removed, (2) to what extent deterioration of service [quality] could instead be prevented merely by imposing standards of quality, safety, financial responsibility, and the like, and (3) whether such additional benefits might be secured by limitations on entry and price rivalry are greater than the benefits that freer competition brings.

It is frequently argued that the trucking industry is subject to destructive competition, hence price and entry should be regulated. Kahn (1971, p. 178) asks the obvious question, "does trucking have the economic attributes of an industry subject to destructive competition?" He answers, "It would be difficult to find one less qualified." He, in turn, cites Professor Pegrum who states flatly that "competition among motor carriers cannot be ruinous" (Kahn, 1971, p. 180).

It should be noted that in cyclical industries in which firms have high fixed costs and low marginal costs during recessions, complaints of destructive competition can often be heard. In the short run prices could fall to marginal cost and firms will not cover average costs, hence they will incur losses. This painful state of affairs could continue for several years until demand recovers and/or the less efficient producers are forced from the industry. Despite the appelation of "cut-throat competition", this situation does not qualify as an example of truly destructive competition so long as exit barriers are low. Hence, sub-normal profits cannot persist over many years. There is no justification for government to intervene in such a situation on the basis of destructive competition -- although the pressure to do so may be great.

6.0 FAILURE IN THE ASSIGNMENT OF PROPERTY RIGHTS: COMMON PROPERTY RESOURCES

6.1 The Concept

Common property rights are, in Dales' (1975) terms, nonexclusive and non-transferable rights whose essential characteristic is that they will be used to the point where marginal utility equals price and the price is zero.

Problems in the efficient exploitation of common pool resources occur when at some level of exploitation production from the pool by one person will decrease the amount of the resource available to others by more than his production (Dales, 1975, p. 495). See also Hardin (1968) on "the tragedy of the commons". It is in this sense that these resources are indivisible. Examples of common property resource problems include the following:

- the reproductive capacity of fish stocks, or a crop (including forests) that is imperiled by overutilization;
- the reduction of pressure of oil/gas well by competitive exploitation results in the total amount recovered being less than what is economically feasible if a single owner were to maximize his returns;
- the broadcasting spectrum is a scarce resource in that at some point additional signals impair the quality of reception of other signals;
- natural air and water systems may be adversely affected by pollution; and
- scenic vistas and natural ecosystems.

The core of the common property resource problem lies in the absence of individuated property rights in some valuable resources. The heart of property rights is the right to exclude others from use except on such terms as the owner and user agree to. The absence of such property rights is not really a failure of the market, but of the prior institutional process which defines and assigns property rights. Common property resources are, in effect, a "gap" in the assignment of property rights to individuals. In fact, we usually ignore one assumption in the conditions for competitive markets to produce a Pareto optimal allocation of resources. It is that all resources involved in market processes are owned by indviduals and subject to excludability. Moreover, it is assumed that contracts by which such resources are exchanged are enforceable according to rules established by a sovereign power. While these rules (laws) may be created by a process involving the consent of the governed, they are assumed to be enforced impartially on all. In other words, market processes are not, as some argue, entirely spontaneous processes, but are preceeded by the actions of collective institutions to define and enforce property rights for all resources

to be allocated by market forces. The point is often ignored by the most fervent critics of government intervention.

6.2 An Example: The Fishery

The nature of the common property resource problem can be illustrated by an examination of the fishery. Both theoretically and empirically it is clear that a fishery that is unconstrained will become unprofitable. Fishing capacity (or "power") grows beyond the level for the efficient harvesting of the resource and may, in fact, ultimately destroy the stock itself or reduce it to an uneconomic level.

Economic efficiency requires that the economic rent[28] from the resource be maximized. In general terms, we can define the rent (R) as follows:

$R = S - C$, where
S = market value of the catch as sold in competitive markets (in present value terms)
C = costs of harvesting the resource, i.e., wages, fuel, capital etc. (in present value terms), including a normal return on capital.

However, the potential rent attracts entrants (more fishermen or larger boats or more "fishing power" incorporated into existing boats) who add to harvesting capacity. All other things being equal, the size of the catch increases (but at a decreasing rate), the costs of harvesting (total and per unit) rise, and the amount of rent is eventually reduced to zero.

Eventually, a "bionomic equilibrium" is reached where the sustained value of the catch just equals the opportunity cost of the resources employed in the industry. In this case the rent is dissipated to zero and the volume of the catch is too large to maximize allocative efficiency.

Too many resources are employed in the fishery because there is open access to the resource. There is open access since the resource is jointly owned by all members of society even though only a relatively few launch a boat and put out nets to catch fish. Everyone, individually, has only a limited property right in the fishery. The critical thing missing is the right of the owner(s) to exclude others from access to the valuable resource.

Common property resources like the fishery create a "rush for the spoils" -- which eventually produces "a tragedy of the commons." Each fisherman seeks rationally to catch as much as he can as quickly as he can. Yet he knows that if all fishermen (and the number is potentially unlimited) pursue the same strategy the stocks will be depleted--in time--to the point that it won't "pay" to go fishing. However, knowledge of this fact creates an incentive for each fisherman, in the case of an open access fishery, to redouble their efforts to make their fortune before others are able to catch "all the (economically exploitable) fish in the sea." Therefore, what is individually rational is collectively irrational as the economic rent is reduced to zero rather than being maximized.

6.3 Government Action to Overcome the Common Property Resource Problem

How can this type of market failure be overcome and thereby increase allocative efficiency? Since the problem stems largely from a failure in the assignment of property rights, government action could take the following forms. First, the government could assign the property rights in the common property resource to a single owner or to a number of individual owners where the resource can be "individualized." In the case of the forests, the forest land could be sold to individuals who will treat the trees as a crop with a very long rotation (60 to 80 years in British Columbia). In the case of the fishery we could sell each of the fisheries (within our national jurisdiction) to one owner who would employ the optimal number of fishermen to catch the fish. Or we could sell the right to catch all the fish in each of a number of areas to individuals. However, fish are fugaceous and some, like the salmon, need to return to freshwater streams to reproduce. Therefore, we are more likely to sell a certain fishing quota to a specified number of fishermen, trying to ensure that the total catch will maximize the rent from the resource. See Scott and Neher et al. (1981). It should be noted that rent maximization, in present

value terms, may result in the virtual erradication of the stock--even if a single individual owns the fishery--if the discount rate (rate of time preference) is sufficiently high.

Second, the government, acting for the collective owners of the common property resource could operate the resource as if it were a single owner (i.e., rent maximization which also results in allocative efficiency) and hire employees to catch the fish. In other words, it could operate the fishery as a Crown corporation: "Fish Can".

Third, the government could use regulation to control access to the fishery and to control the volume of fish caught so as to prevent dissipation of the rent. The history of such regulation in Canada makes it clear that this is difficult to do for a variety of reasons: technically, it is hard to know what is the size of the fish stock, how rapidly it is reproducing and dying off and even how many are being caught. It is difficult to predict the behavioural response of fisherman to various types of controls, e.g., when limits were placed on the size (length) of vessels, fishermen engaged in "capital stuffing" (larger nets, power winches, better electronics) to increase their "fishing power." In addition, fish cross national boundaries within "economic zones" and it is hard to determine the size of adjacent nations' stocks. Politically, the regulation of the fishery is difficult because the objective of rent maximization (allocative efficiency) clashes with employment objectives in certain regions with high unemployment rates and few alternative types of employment. Hence, a "social fishery" implies a result closer to the "bionomic equilibrium" whereby all the rent is dissipated, but more men and boats are employed (many underemployed) in the fishery. See Kirby (1982).

The complexity of government's management of common property resources is described by Dales (1975, p. 496) as follows:

> What governments must do about pools is to determine, as best they can, the economically efficient rate of production from them and ensure that it is not exceeded. But that is only the beginning of the complexity. Given the rate of production, how many producers should there be? How should the production rights be allocated? Should they be auctioned off, as economists usually recommend? Or should effluent quotas, or broadcasting rights, be assigned free of charge to producers chosen by some non-price 'eligibility' criterion? Should the number of fishermen, or the size of catch per fisherman, or the total catch be restricted? Does allocation of the broadcasting spectrum imply control of cable television? And so on. Given the technological complexities of common pool resources, the technological differences between them, and the difficulty of designing and enforcing restrictions appropriate to the technological situation involved, optimum regulation from an economic point of view in any particular case poses a challenging problem in applied social science.

7.0 IMPERFECT KNOWLEDGE (UNCERTAINTY)

7.1 The Problem in General

In its extreme form, the theory of perfect competition assumes that all economic actors have perfect knowledge. Zeckhauser (1970, p. 96) states, "the neoclassical model of perfect competition requires perfect knowledge; there can be no uncertainty. The presence of uncertainty, a lack of knowledge of which state of nature will obtain in the future, makes the model inoperative."

As I shall discuss, the minimal conditions for markets to be effectively competitive all actors must be equally knowledgable/ignorant (enjoy a symmetric position) and they must face a supply curve for information that is not subject to significant economies of scale (increasing returns). More generally, Schultz (1977, p. 36) observes that

> Market transactions cannot be an efficient method of organizing human activity unless both the buyer and the seller understands the full costs and benefits to them of the transactions they undertake, including any side effects that impinge on their own welfare.

The Economic Council of Canada (1979, p. 48) notes that "in a world of increasing specialization and complex technologies, the information for intelligent decision making, about a wide variety of goods and services cannot be summed up in their observable characteristics."

7.2 The Problem in More Detail

The nature of the problem for efficient resource allocation attributable to imperfect knowledge can be outlined as follows. First, there is often asymmetry in the level of knowledge (ignorance) between buyers and sellers. Typically, the seller has much more information about the performance characteristics of the product or service he is selling than does the buyer. The buyer -- perhaps to his dismay -- may in time learn about these characteristics, but he can usually do so only after buying the product. Experience can be a good teacher, but it is often a painful or expensive one. Perhaps it was in recognition of this asymmetry that the legal principle of "caveat emptor" came into being. Note, however, that while households may be informationally disadvantaged vis-a-vis retailers and manufacturers, commercial buyers usually are not. When a government is buying a huge volume of carpet (or other items) it can obtain a sample and send it to a lab to have its properities tested, or it can hire a former executive from the carpet industry to advise it about the best purchase for its needs.

Second, the asymmetry in the level of knowledge is often exacerbated by the shape of the cost function for acquiring information to dispel one's ignorance. The cost function may be such that information as a good cannot be produced in a competitive market. At the extreme, the supply of information may have certain public good characteristics, i.e., jointness in supply such that once the high fixed costs of production are incurred, the marginal costs (usually only of distribution) are virtually zero. Moreover, in some cases, there may be external economies in the consumption/use of information i.e., its use by one individual does not reduce its value (amount available) to others. (Note, in strategic situations this is manifestly not true.) Therefore, these conditions create difficulties (sometimes insurmountable) for information entrepreneurs and hence the volume of information supplied by markets will be too low for efficient resource allocation.

Davis and Kamein (1970, p. 79) point out that if knowledge of a good's characteristics is known, then the "consumption" of that knowledge by one shopper does not diminish the availability or usefullness of that knowledge for any other shopper. The producer of information faces the problem of incurring costs to produce/acquire information that he is unlikely to be able to recoup by selling it to users. But even if he could somehow control access to the information, it is socially inefficient to charge more than the low marginal cost of making it available to additional users.

Third, the costs of ignorance in economic and/or physical terms may be very large and/or the nature of the error irreversible. Moreover, the size and/or infrequency of transactions may make it difficult or impossible for buyers to experiment with a product or service. Consider the problem of the person contemplating brain surgery. The failure to employ a highly skilled and conscientious specialist could result in death or--perhaps worse--waking up and finding that one has become "a vegetable." Clearly one cannot experiment in this situation. In contrast one can buy a can of beans, cook them and taste the result. If they are unsatisfactory throw them out at a cost of less than a dollar and try another brand. Clearly too there is a huge difference in what the patient knows about the skills of alternative doctors and what other specialists in the same field (or hospital pathologists) know. In addition, such information is hard to obtain.[29] While Consumers' Reports rates tires and toasters, they don't publish statistics on the records of doctors, lawyers or airline pilots.

This particular example leads us to the fourth aspect of the information failure problem. Even when the relevant information is available, it is hard for the lay person to understand, interpret and utilize, e.g., what would a patient do with a complete medical file on his illness which is written entirely in medical/scientific language? What use could the average citizen make of the

six volumes of the federal government's annual Public Accounts as a source of information on the performance of the party in power?

Effectively, many decisions are made for us by specialists--usually professionals--acting as our agents. The "agency problem" occurs because the agent (e.g., a doctor) has both more/better information than the person on whose behalf the purchase is being made (principal). Therefore, the agent is able to influence the decision of the principal, and the agent may be in a position to supply goods or services to the principal to the agent's benefit.[30] In other words, the doctor not only performs the diagnosis, but he usually provides the treatment that he recommends to the patient. The same is true of lawyers, dentists, engineers, and other professionals. The agency relationship creates a moral dilemma for the agent. Whose interests are to be paramount, his own or his principal's? From the principal's perspective, this problem has been summarized in the phrase, "don't ask the barber if you need a haircut."

7.3 Uncertainty and Contingent Claims Markets

The existence of uncertainty need not prevent competitive markets from achieving allocative efficiency if there exists markets for contingent claims as well as for goods and services. (A contingent claim is a right to a variable amount of a commodity or money, the amount of which depends upon what state of nature actually occurs.) But contingent claims markets may, themselves, be inefficient because of the presence of substantial transaction costs. The most important issue is whether there *is* a contingent claims market in all areas where society would benefit from its existence.

> With fair and perfect contingent claims markets, uncertain incomes will not be of consequence. The risk-averting individual will be able to insure that he receives the expected value of his future income. There will be no additional transfers in response to risk considerations (Zeckhauser, 1970, p. 105).

Zeckhauser (1970, pp. 98-104) shows that in situations where individuals are unable to predict their portion of future total demand (probabilistic individual preferences), they may find it useful to make some decisions on the collective provision of a good before preferences become known. "The [U.S.] social security system is a good example of a nonvoluntary, risk-sharing arrangement implemented by a political unit" (Zeckhauser, 1970, p. 103).

7.4 Options for Government Action

The Economic Council (1979, p. 49) states that "there are two basic types of regulatory approaches that can be used [by government] to try to remedy this type of market failure: requiring the provision of adequate truthful information; and the licensing of, or setting standards for,[31] those who have the information necessary to help individuals make rational decisions."

> The acquisition of information may enable us to ameliorate the effects of uncertainty, it may permit us to make informed predictions about future states of nature. We can then change our actions in response to these predictions so as to increase our expected payoffs (Zeckhauser, 1970, p. 113).

Actually, there are other types of government action that can/may be taken to overcome information failure. First, the government can define and enforce through the courts legislation that specifies the liability of each actor for various actions they may take. This is a form of property rights solution. The efficacy and efficiency of this approach has been the subject of much debate. See the discussion in Mackaay (1982) and Polinsky (1983) and the articles cited therein.

Second, the government, instead of requiring private parties to provide/ disclose information, could actually provide the information necessary to overcome the buyers/sellers' lack of knowledge. For example, the former Commissioner of Insurance in Pennsylvania (Denenberg), had his expert staff undertake a careful assessment of the attributes of life insurance policies sold

in the state. He then published this sort of "consumer's report" much to the dismay and hostile reaction of the insurance industry.

Third,--and this does not ameliorate the market failure in efficiency terms--the government could fund a compensation scheme for those who suffer adverse consequences as a result of inadequate information. This is the approach embodied in the creation of the "Super Fund" in the U.S. to assist those aversely affected by toxic chemicals. See also Swaigen (1982) and Quinn and Trebilcock (1981). This approach addresses the distributional consequences of the market failure, but not the allocative aspects.

In all cases, including those outlined by the Economic Council noted above, efficiency requires that no government action be undertaken where its costs (i.e., the cost of intervention) exceed the social costs of the information failure.

One other type of government intervention to deal with the problem of uncertainty (or imperfect knowledge) in a dynamic world needs to be mentioned. It is the use of regulation as a means to enforce an administered contract between the providers of a specialized good or service, produced in a capital-intensive process and that is subject to increasing returns to scale. Goldberg (1976) argues that the administered contracts approach, enforced by a regulatory authority, can be understood as a means of coping with uncertainty (limited information) in a dynamic world. Such contracts are ways of more efficiently handling risks, attributable to imperfect knowledge, to both suppliers and customers where the relationship has to cope with a variety of contingent issues over a long period of time. In other words, the relationship is continuous, hence the discrete transactions approach is inappropriate.[32]

The equilibrium position under Goldberg's model is the balance between the protection of a producer's right to serve and a consumer's rights to be served. By increasing the protection of a producer's right to serve the contract becomes

more attractive to producers and less attractive to consumers. The reciprocal relationship also holds, i.e., the producer views any increase in the consumer's right to be served as an added cost of production. Goldberg refers to two such protection devices frequently found in private contracts: liquidated damages for premature termination; and exclusive dealing arrangements. He concludes that natural monopolies have characteristics which make the protection of producer's interests very attractive. These are typically very capital-intensive industries with extremely long-lived and relatively immobile capital.

The consumer's right to be served needs to be protected, especially in the regulatory sector, for three reasons: once the relationship has begun the supplier will be isolated to some degree and will be in a position to use price discrimination in an attempt to capture the ex post consumer surplus; the single consumer is susceptible to arbitrary and capricious treatment; and the consumer requires a mechanism to deal with honest errors.

Goldberg's approach, in effect, provides an information failure argument for traditional public utility regulation. His analysis implies that some of the traditional criticisms of such regulation may be based on a misunderstanding of the market failure that is being addressed by the imposition of regulation.

Goldberg (1976, p. 445) suggests that, "many of the problems that arise in regulated industries would arise even if the industries were not under the jurisdiction of a regulatory agency." He continues,

> The administered contracts approach provides a very different perspective for examining regulatory institutions. The "justification" of regulation is seen to rest not on narrow natural monopoly (declining long-run average costs) grounds; rather it rests on the long-term relational matters stressed here. Thus, the observed emphasis by regulatory agencies on protection from competition, which appears quite anomalous within the standard framework, has a plausible explanation in this broader context (Goldberg, 1976, p. 445).

Two closely-related criticisms of regulation, that it unduly restricts entry, and that it discourages technological change, make regulation look

inefficient in a short run, discrete-transaction world. However, such an analysis ignores the importance of the protection of a right to serve when a long run continuous relationship is necessary. Goldberg (1976, p. 435) argues:

> Would the firm have come into the market initially without some protection from competition? Would it have come in on terms as favorable as it did? That is, if we view the protection afforded by the regulatory agent as forward looking, we can see it as a road to innovation rather than a hindrance.

He suggests that while regulation may be overly protective in some instances, "there is no reason to presume that a private contract would lead to the optimal amount of protection."

As we shall see, the problem of imperfect information is also part of the problem of transaction costs to which we now turn.

8.0 TRANSACTION COSTS

8.1 A "Fuzzy" Concept

Coleman (1984, p. 666) states that "no term in the philosopher's lexicon [such as 'justice' or 'fairness'] is more imprecisely defined than is the economist's term 'transaction costs'. Almost anything counts as a transaction cost." Williamson (1979, p. 233) quotes Fischer (1977) on the problem of defining transaction costs as follows: "transaction costs have a well-deserved bad name as a theoretical device ...[partly] because there is a suspicion that almost anything can be rationalized by invoking suitably specific transaction costs."

In general terms, we can think of transaction costs as being the costs of exchange that are not embodied in the stated price of the good or service being exchanged. Arrow (1970, p. 60) notes that transaction costs "are costs of running the economic system". They are resources used up in the process of exchange in order to allocate resources.

If a buyer or seller is hard to find, difficult and time-consuming to deal with, and unreliable in terms of delivering the goods/services as agreed, then dealing with him involves higher transaction costs than someone who is conveniently located, easy to deal with, and is reliable.

8.2 Significance of Transaction Costs

Transaction costs have a powerful influence on the modes of organizing economic activity -- whether exchanges occur between legally independent actors in markets or between employees (different sub-units) of a single firm. They influence whether decentralized market exchange is emphasized or whether central planning is used to authoritatively allocate resources. Williamson (1979, p. 233) puts it this way: "if transaction costs are negligible, the organization of economic activity is irrelevant, since any advantages one mode of organization appears to hold over another will simply be eliminated by costless contracting".[32]

Demsetz (1968a, p. 33) explains the significance of transaction costs as follows. In an economic system in which transaction costs are zero "the usual sources of inefficiency fail to exist...". With respect to externalities, he notes that costless negotiations between pollution emitters and "recipients" will bring the output of harmful effects to efficient levels -- to the level where it no longer pays to reduce them further. See also Coase (1960). The adverse effects of market power (e.g., monopoly) will be overcome as buyers will offer side payments to suppliers to produce a more allocatively efficient level of output. The result will be a "bigger pie to be shared by all".

Calabresi (1968, p. 68) argues that "if one assumes rationality, no transaction costs, and no legal impediments to bargaining, all misallocations of resources would be fully cured in the market by bargains". In other words, transactions will continue to occur to the point where all gains from trade have been exhausted which is optimal resource allocation.[33] As a result, "all

externalities can be internalized and all misallocations, even those created by legal structures, can be remedied by the market itself, except to the extent transactions cost money or the structure itself create some impediments to bargaining" (Calabresi, 1968, p. 68).

However, Coleman (1984, p. 665) points out, that if exchange is perceived of as a bargaining game, "higher transaction costs may induce successful negotiations by encouraging parties to lessen their demand and to reconcile their differences for fear that continued negotiations may lead to a vanishing surplus". In fact, without some external force, costless private exchanges may prove anything but efficient.

For non-economists, the importance of free exchanges must be emphasized. Such exchanges are productive in the sense that both sides are better off (or at least no worse off) as a result of the transaction. In other words, there are gains from trade. The buyer pays less than the product is worth to him, i.e., he enjoys some consumer surplus. The seller obtains revenues greater than his costs of production expressed in opportunity cost terms. But all exchanges involve an element of bargaining, no matter how perfunctory it appears. Some exchanges, for example, the purchase of a car or house or stereo system, often involve overt and sometimes lengthy bargaining. The effect of transaction costs is to reduce the amount of the total surplus (consumers plus producers) available to be divided among the parties. The presence of transaction costs, therefore, means that all gains from trade are not exhausted. Individuals could be made better off (and others no worse off) if transaction costs were lower than they are in a given situation.

The sweep of the arguments of Demsetz and Calabresi is extraordinary. They say, for example, that if transaction costs are zero, market failures such as public goods, monopoly power, common property resources, externalities and imperfect knowledge can be overcome by uncoerced bargaining (voluntary

exchanges) among market transactors. Calabresi (1968, p. 69) himself, puts it this way, "the resource allocation aim is to approximate, both closely and cheaply, the result the market would bring about if bargaining actually were costless". The matter for public policy is to determine which means of organizing economic activity is the most efficient, for example, structural rules, liability rules, government taxation and spending, or by leaving the market entirely alone. Policy makers have to consider both the cost of reaching the correct result using these or other alternatives, and they have to consider the probability that a particular mode of economic organization will be widely wrong. These matters together amount to the problem in determining the optimal allocation of resources in Calabresi's view.

8.3 Types and Sources of Transaction Costs

Despite the work of Williamson (1975), (1979) and others, Dahlman (1979, p. 143) asserts that "no systematic analysis exists of the nature of transaction costs." The literature, in Dahlman's view, contains three interpretations of transaction costs:

(i) A fixed percentage of whatever is being traded disappears in the transaction itself. The best analogy is to the role of transportation costs as distinguished from production costs. Arrow (1970, p. 69) argues that "the welfare implications of transaction costs would exist even if they were proportional to the size of the transaction, but in fact they typically exhibit increasing returns. The cost of acquiring a piece of information, for example, a price, is independent of the scale of use to which it will be put."

(ii) Transactions (exchanges) require set-up costs to organize. Some of these are fixed and independent of the size of the transaction. This introduces a nonconvexity which gives the formal mathematics of optimization great difficulties. The best analogy to this concept of transaction costs is to the

fixed costs of production in the short run. The implications of transaction-specific investments are developed by Williamson (1979). See below.

(iii) There is Coase's (1960) idea of transaction costs as including search costs, the cost of acquiring information about all opportunities for exchange, bargaining and decision costs in making contracts, the costs of monitoring or policing contracts, and the costs of enforcing contracts in the event of a violation of their terms. Dahlman (1979, p. 148) argues that all of these categories, reduce to one: "resource losses due to lack of information".[34]

Alchian and Demsetz (1972) identify several problems in contracting in the real world which give rise to transaction costs.[35] First, output and inputs must be metered in order to measure so as to apportion and connect reward to performance. Second, exchanges must be monitored to prevent shirking in the case of team production and to ensure that contract terms are adhered to. Third, there are the costs of negotiations to arrive at a contract -- these may be small when one is a price taker and simply puts a quarter into the pay phone and waits for the dial tone, or they may be large as when the auto workers negotiate a new collective agreement with General Motors. Calabresi (1968, p. 68) would include the costs of excluding potential free riders as a transaction cost.

Arrow (1970, p. 68) suggests there are three sources of transaction costs: exclusion costs, costs of communication and information, and the costs of disequilibrium. The last cost refers to the fact that in any complex system it takes time, even with perfect information, to compute the optimal allocation -- either transactions take place which are inconsistent with the final equilibrium or they are delayed until the computations are completed.

Williamson (1979) argues that there are three important characteristics of transactions which give rise to transaction costs. In their order of significance, they are:

- uncertainty (imperfect knowledge);
- the degree to which durable, transaction-specific investments are incurred to facilitate exchange; and
- the frequency with which transactions of a given type recur.

The last two do not stem from market failure, but are attributable to real technological limitations in nature. Williamson (1979, pp. 245-6) states that the "economics of transaction costs essentially reduces to the economics of bounded rationality while simultaneously safeguarding the transaction in question against the hazards of opportunism."

Williamson (1979) analyzes transaction costs in terms of what he calls the "economics of idiosyncrasy". First, he notes that there are a number of transactions where the specific identity of the parties has important cost-bearing consequences. Where a buyer or a seller invests in specialized physical capital to facilitate exchange with a particular party, their investment has no other useful purpose and hence they are vulnerable to the actions of the other party if they have not made a similar investment.

Second, a continuous relationship between buyers and sellers, with the passage of time, may produce economies of communication and of adaptation to each other's needs as "both institutional and personal trust relations evolve." The possibilities of opportunistic behavior are often eschewed when the benefits of a good working relationship (the spirit, not the letter of the contract) are apparent to the individuals directly involved.

Third, the assurance of a continuing relationship is needed to encourage specialized investments, but it is virtually impossible to specify in a long-term contract all contingencies and the appropriate responses to them. "Intertemporal efficiency nevertheless requires that adaptations to changing market circumstances be made" (Williamson, 1979, p. 241). But both parties face the incentives and hazards of opportunism.

Williamson (1975, p. 26) defines opportunism as involving the making of false or empty threats and promises (i.e., self-disbelieved) in the expectation that individual advantage will thereby be realized. Opportunism involves the strategic manipulation of information or misrepresentation of intentions which cannot be avoided by any type of self-enforcing commitment. A necessary condition for behavior to be opportunistic is that the small numbers condition prevails (Williamson, 1975, p. 27). Even where a large number of potential buyers/sellers exist, where a transaction-specific investment is necessary for both parties, the situation is effectively converted into one of bilateral monopoly.

Recent developments in the mortgage market illustrate the idea of opportunism. As interest rates rose with inflation and became more volatile, the period over which the rate was fixed declined from five to one year or even less. Homeowners discovered that when they went to renew their one-year mortgage their lender was able to charge them a quarter or one-half a percentage point more than other lenders. Why? Their present lender was able to benefit from the fact that other lenders required the homeowner to incur substantial transaction costs (a new appraisal, legal fees, registration fees) if they were to grant the mortgage at the going market rate. Therefore, the present lender, whose own transaction costs of renewing the mortgage were trivial, could exact almost the full amount of the borrower's cost of switching.

In general, Williamson (1979, p. 242) notes that where transaction-specific investments are required to facilitate exchange,

> both buyer and seller are strategically situated to bargain over the disposition of any incremental gain whenever a proposal to adapt [alter their contract in the face of some exogenous event] is made by the other party. Although both have a long-term interest in effecting adaptations of a joint profit-maximizing kind, each also has an interest in appropriating as much of the gain as he can on each occasion to adapt.

Because the mutual gains may be dissipated in bargaining costs, Williamson (1979, p. 242) argues that "governance structures which attenuate opportunism and otherwise infuse confidence are evidently needed."[36] It should be noted that Williamson does not address the question directly whether transaction costs are a form of market failure.

8.4 Are Transaction Costs a Type of Market Failure?

Is the existence of transaction costs a form of market failure in the same way we think of public good, externalities and imperfect knowledge as market failures? There appear to be conflicting answers. As we shall see, K.J. Arrow, a Nobel Laureate in Economics, suggests that positive transaction costs can be considered to be a form of market failure. In his concept of Pareto optimality -- the criterion state from which other allocations are judged in efficiency terms -- transaction costs are assumed to be zero.

On the other hand, both Demsetz and Dahlman argue that the presence of transaction costs *per se* is not a type of market failure, rather the issue is whether an alternative mode of economic organization would lower the present level of transaction costs. In their approach, Pareto optimality as the criterion should be an attainable optimum recognizing that so long as human beings engage in exchange there will be positive transaction costs.

Arrow (1970, p. 61) in a "quick review of the familiar theorems on the role of perfectly competitive equilibrium in the efficient allocation of resources", notes that two implicit assumptions are that "all prices can be known by all individuals and that the act of charging prices is not itself a consumer of resources". This suggests that positive transaction costs are a type of market failure. So does the following remark in the same article: "in a price system, transaction costs drive a wedge between buyer's and seller's prices and thereby give rise to welfare losses as in the usual analysis" (Arrow, 1970, p. 68). On the other hand, Arrow (1970, p. 63) states that "it is not the presence of

bargaining costs per se but their bias that is relevant. If all bargaining costs are high, but competitive pricing and the markets are cheap, then we expect the perfectly competitive equilibrium to obtain, yielding an allocation identical with that under costless bargaining."

This last point suggests that Arrow is thinking of competitive market pricing, where all the relevant information is provided in the quoted price, as a substitute for bargaining in the sense of haggling over the terms of the exchange. If this is the case, then he is saying that an alternative form of economic organization can exhibit lower transaction costs. This brings him closer to the position of Dahlman and Demsetz.

In general terms, Arrow (1970, p. 68) argues that a market failure occurs when "transaction costs are so high that the existence of the market is no longer worthwhile". The significance of this point lies in the fact that if markets are universal (and certain other conditions hold), a competitive equilibrium is Pareto-efficient. Arrow (1970, p. 68) distinguishes between transaction and production costs as follows: "the former can be varied by a change in the mode of resource allocation, while the latter depend only on the technology and tastes, and would be the same in all economic systems".

Demsetz (1968a, p. 33) suggests that the existence of transaction costs is <u>not</u> evidence of a market failure. He states "of course the existence of positive transaction costs has no direct relevance to economic inefficiencies". He continues, "as with any cost, the question that is relevant for efficiency is whether or not the cost is appropriately economized". The existence of transaction costs means, as we have noted, that not all potential gains from trade can be exhausted.

The core issue with respect to transaction costs, Demsetz suggests, is to determine which mode of economic organization "realigns resources more completely". Can society achieve a Pareto optimal allocation of resources by,

Because the mutual gains may be dissipated in bargaining costs, Williamson (1979, p. 242) argues that "governance structures which attenuate opportunism and otherwise infuse confidence are evidently needed".[3] It should be noted that Williamson does not address the question directly whether transaction costs are a form of market failure.

8.4 Are Transaction Costs a Type of Market Failure?

Is the existence of transaction costs a form of market failure in the same way we think of public good, externalities and imperfect knowledge as market failures? There appear to be conflicting answers. As we shall see, K.J. Arrow, a Nobel Laureate in Economics, suggests that positive transaction costs can be considered to be a form of market failure. In his concept of Pareto optimality -- the criterion state from which other allocations are judged in efficiency terms -- transaction costs are assumed to be zero.

On the other hand, both Demsetz and Dahlman argue that the presence of transaction costs per se is not a type of market failure, rather the issue is whether an alternative mode of economic organization would lower the present level of transaction costs. In their approach, Pareto optimality as the criterion should be an attainable optimum recognizing that so long as human beings engage in exchange there will be positive transaction costs.

Arrow (1970, p. 61) in a "quick review of the familiar theorems on the role of perfectly competitive equilibrium in the efficient allocation of resources", notes that two implicit assumptions are that "all prices can be known by all individuals and that the act of charging prices is not itself a consumer of resources". This suggests that positive transaction costs are a type of market failure. So does the following remark in the same article: "in a price system, transaction costs drive a wedge between buyer's and seller's prices and thereby give rise to welfare losses as in the usual analysis" (Arrow, 1970, p. 68). On the other hand, Arrow (1970, p. 63) states that "it is not the presence of

bargaining costs per se but their bias that is relevant. If all bargaining costs are high, but competitive pricing and the markets are cheap, then we expect the perfectly competitive equilibrium to obtain, yielding an allocation identical with that under costless bargaining."

This last point suggests that Arrow is thinking of competitive market pricing, where all the relevant information is provided in the quoted price, as a substitute for bargaining in the sense of haggling over the terms of the exchange. If this is the case, then he is saying that an alternative form of economic organization can exhibit lower transaction costs. This brings him closer to the position of Dahlman and Demsetz.

In general terms, Arrow (1970, p. 68) argues that a market failure occurs when "transaction costs are so high that the existence of the market is no longer worthwhile". The significance of this point lies in the fact that if markets are universal (and certain other conditions hold), a competitive equilibrium is Pareto-efficient. Arrow (1970, p. 68) distinguishes between transaction and production costs as follows: "the former can be varied by a change in the mode of resource allocation, while the latter depend only on the technology and tastes, and would be the same in all economic systems".

Demsetz (1968a, p. 33) suggests that the existence of transaction costs is <u>not</u> evidence of a market failure. He states "of course the existence of positive transaction costs has no direct relevance to economic inefficiencies". He continues, "as with any cost, the question that is relevant for efficiency is whether or not the cost is appropriately economized". The existence of transaction costs means, as we have noted, that not all potential gains from trade can be exhausted.

The core issue with respect to transaction costs, Demsetz suggests, is to determine which mode of economic organization "realigns resources more

completely". Can society achieve a Pareto optimal allocation of resources by, in some cases, substituting government action for market processes? By economizing on transaction costs we can improve allocative efficiency by permitting transactors to more nearly exhaust all possible gains from trade.

Dahlman (1979, p. 142) appears to see transaction costs in much the same way as Demsetz, for he states, "if there were no costs of transacting, then [all] potential Pareto improvement[s] could be realized by costless bargaining between self-interested economic agents" (Dahlman, 1979, p. 142). Dahlman (1979,p. 143) concludes that "it is not possible to specify any class of transaction costs that -- given individual wealth-maximizing behaviour under well-specified constraints that include exchange costs -- generate externalities that constitute deviations from an _attainable_ optimum..." [emphasis in the original]. In other words, transaction costs _per se_ do not denote the existence of a market failure.

One of Dahlman's main contributions to the discussion of whether transaction costs are a form of market failure lies in the following point: economists use the concept of a Pareto optimum in a general equilibrium system as the point of reference in discussing market failures such as externalities. However, by definition, a Pareto optimal allocation of resources (the reference model) contains no externalities, hence transaction costs must be zero. Dahlman (1979, p. 150) concludes that "the policy implication that the government must intervene [where Pareto optimality does not obtain for a given distribution of resource ownership] rests on the implicit comparison of a world with transaction costs with one with zero transaction costs."

Dahlman notes that the real world is plagued by various types of transaction costs. It would be desirable to reduce such transaction costs, just as it would be desirable to decrease a firm's production costs. However, "surely there must be something more of substance in the reference to the Pareto

optimum" (Dahlman, 1979, p. 152). In other words, to use as a reference standard to measure the efficiency of different allocations of resources a definition of Pareto optimality which excludes any transaction costs, is to create a criterion that is empty of practical significance. Dahlman (1979, pp. 152-153) argues that the reference standard from which we measure distortions due to market failures such as externalities, "should include [transaction] costs in the constraints that specify the Pareto optimal solution..." He offers two reasons. First, not all market failures are Pareto relevant, i.e., not all are worth reducing to zero. Second, following Demsetz' (1969) critique of Arrow, "it is a logical fallacy to use as a frame of reference a world in which transaction costs are zero, for that world is unattainable, given human behavior in our world." Transaction costs are inherent and unavoidable in market exchange processes involving human beings. The more general point for welfare economics is that the criterion should be attainable in principle.

Herbert Simon (1957, p. 198) reminded us almost three decades ago that "the capacity of the human mind for formulating and solving complex problems is very small compared to the size of the problems whose solution is required for objectively rational behavior in the real world". Therefore, man must function in a way Simon describes as bounded rationality.

If Dahlman's (1979, p. 158) approach ("transaction costs are a necessary condition for deviation from an attainable optimum to persist") is adopted, under what conditions are transaction costs a "problem"? First, we should note that the existence of transaction costs is not a market failure per se. The problem -- which should be described as an "organizational failure" -- occurs when actual transaction costs are greater than the lowest attainable level (but not zero). So long as transaction costs could be reduced by substituting one

form of economic organization for another, an "organizational failure" exists.[37] A change in mode of organization may involve substituting government action for markets where the former includes the establishment of liability rules, structural rules or the direct provision of goods and services based on decisions derived from political markets. Or it may involve the substitution of hierarchies for markets -- see Williamson (1975).

Dahlman (1979, p. 161) concludes that "in the final analysis... market failures are not what is the matter with the world, [they do not] prevent us from re-establishing the Garden of Eden here on earth -- our sad state of affairs is rather due to positive transaction costs and imperfect information". Transaction costs prevent Pareto optimal bliss from ruling sublime.

Notes to Chapter 2

1. The idea that the existence of a market failure is not a sufficient condition for a government to intervene is discussed in Stanbury (1985, Chapter 5).

2. I note that there are at least three concepts of economic efficiency of which allocative efficiency is only one. The others are technical efficiency and dynamic efficiency. The former is a static measure of how closely a firm is able to achieve the lowest attainable level of costs, given factor prices, and technology. When a firm's actual costs are above the lowest level attainable, we often say - following Leibenstein - that the firm is subject to X-inefficiency. Dynamic efficiency is a less well specified concept based on the idea of the efficiency of a firm ove time, i.e., its ability to create and utilize technological change to increase output per unit of input and to create new products and services that are more highly valued by society than current ones. In general, see Shepherd (1979).

3. As I shall make clear in section 8, Dahlman (1979) argues that it is analytically empty to assume zero transaction costs in the reference standard against which all other allocations of resources are to be measured.

4. This is a "slippery" concept. See Scherer (1980).

5. See the discussion in section 4 below.

6. See, for example, Kaiser (1982), MacCrimmon (1983) and Gorecki and Stanbury (1984).

7. See, for example, Trebilcock et al. (1978), Stanbury and Lermer (1983), Baggaley (1982).

8. This term, for example, was used by Musgrave (1958) and by Alt and Chrystal (1983, p. 177).

9. See Maital (1979) for a different approach using survey data.

10. Samuelson (1969, p. 98) refers to Pantaleoni (1883), Sax (1883), Mazzola (1890), Wicksell (1896) "and above all" to Lindahl (1919).

11. Samuelson (1969) and Musgrave (1969), among others, emphasize that while the public sector must <u>provide</u> public goods, it need not <u>produce</u> them. Provision usually requires the imposition of taxes which may be used to pay private firms to actually produce the goods. Distribution, however, is usually (but need not be) reserved for a public authority.

12. Dorfman (1969, p. 250) puts it this way:

> public goods are those that are consumed jointly rather than severally. They are goods that place us all in the same boat willy-nilly. They have no marginal cost that can be assessed, even conceptually, against an individual occasion of use. Therefore, they cannot have declining marginal costs.

Page (1983, p. 147) observes:

> Curiously, many public goods, which are supposed to be indivisible, are provided in quite divisible fashion and parcelled out in what Lowi calls a "distributive" manner among congressional districts. Local contracts and other interests seek concentrated private benefits from providing these public goods while the general public tends to be unaware of their diffuse costs. Hence, vote-seeking (and money-seeking) congressmen want pork barrel projects of post offices, military bases, dams, and the like for their districts, and bureaucrats happily allocate programs to expand congressional support.
>
> On a more national basis, too, relatively monolithic interest groups tend to dominate the policy-making process. Public goods (unlike, say, social welfare policy) do not usually divide business from labor or one economic sector from another. Practically all organized interests who care about the subject favor military spending, highway building, and space exploration. Thus, such goods tend to be overprovided and to be provided in ways that are inefficient and excessively favorable to high-income people (Page, 1983, p. 147).

13. Olson (1965) shows that public goods may be provided as a "by product" of activities by voluntary organizations to provide individually appropriable, excludable goods or services.

14. Page argues that there may be a "structuralist" explanation for the large size of the government in the economy. It emphasizes that

> in any capitalist economy (perhaps in any market system) it is a functional imperative that government provide tools that the market fails to provide efficiently. Otherwise everyone loses. And the more advanced and industrialized the economy, the more externalities there are likely to be -- the more smoke and garbage and noise and congestion; the more people and things to defend from attack, and the fancier technology for doing so; the more sophisticated scientific research; the more interdependence in every sphere of life -- hence the more spending needed on public goods (and, if people believe in limited budgets, the more money diverted from possible redistribution) (Page, 1983, p. 154).

15. The discussions over the exact nature of various types of goods can be arcane and not very fruitful. Samuelson (1969, p. 109), who is both theoretically powerful and also practical, states that the useful terminology should be: "pure private goods in which the market mechanism works optimally, possible close approximations to them, versus the whole field of consumption-externalities or public goods".

16. There are other goals embodied in this policy -- see Gorecki & Stanbury (1984).

17. This ignores the problem of "second best". See Lipsey & Lancaster (1956).

18. This assumes that the social costs of intervention are less than the social costs of living with the market failure. Some externalities are not worth correcting, e.g., if the neighbour has only one or two loud parties per year, to which you are not invited, you are unlikely to go to the effort of getting city hall to pass a new anti-noise ordinance. You may, however, request an invitation or ask the revellers to "cool it" if your sleep is being disturbed. Generally, see Stanbury (1981, Ch. 5).

19. The response of the firm depends upon the price elasticity of its "demand function" for pollution. Even very wealthy firms may sharply reduce their volume of a pollutant if the cost of the tax is more than the cost of abatement. However, some people feel that taxing pollution amounts to implicity giving "the rich" the "right to pollute." Hence they favour regulation to either prohibit certain emissions entirely or to reduce them to a "tolerable" level.

20. See section 6 below.

21. This is because the cost of asserting the right on behalf of all the owners (and it is not clear one person could actually bring such an action) is almost certainly less than the benefits the individual can receive from preventing the pollution. All the other owners can be "free riders." In such cases, class actions may be a solution.

22. Coleman (1984, p. 665) points out that transaction costs may be necessary to induce successful negotiations between private parties.

23. It is not unreasonable to view significant negative externalities largely as distributional issues. As a frequent long distance air traveller I believe it is unfair/inequitable that I should be made distinctly worse off (aesthetically, in terms of objective health risks, and in terms of dry cleaning costs) by the emissions of smokers. To me, in this situation at least, efficiency considerations are less important than inequity of having to bear costs, involuntarily, for the pleasures of other individuals.

24. Bator (1958) points out that the Marshall-Pigou prescription to harmonize private production decisions with public welfare by taxing those industries with rising supply curves and subsidizing those who enjoy externalities has been drastically altered over time. Today the modern formulation of external technological economies is assimilated under the broader doctrine of direct interaction:

> Such interaction whether it involves producer-producer, consumer-consumer, producer-consumer, or employer-employee relations, consists in interdependencies that are external to the price system, hence unaccounted for by market valuations. Analytically, it implies the nonindependence of various preference and production functions. Its effect is to cause divergence between private and social cost-benefit calculation (Bator, 1958, p. 358).

25. I am indebted to Fred Thompson, Columbia University, for assistance on the balance of this subsection.

26. Jeanniot's discussion was contained in a comment on Reschenthaler and Stanbury (1983) submitted to Canadian Public Policy and later withdrawn after Reschenthaler and Stanbury had written a reply and both articles had been typeset.

27. Reschenthaler & Stanbury (1983) show that the airline industry does not have the structural characteristics outlined by Kahn (1971) that will produce truly destructive competition.

28. The term "rent" will arise in this study in several different contexts. Economic rent with respect to a natural resource refers to the difference between the market value of the resource less the costs of harvesting including any processing activities to put it into the form desired by buyers. This net amount accrues to the owner of the resource and, in effect, is attributable to the bounty of nature. Economic rent is a term also used by some authors to refer to the returns to owners over and above the normal return on their capital. In other words, the excess profits of a monopolist are described as economic rent. Most economists would refer to such temporary excess profits as a quasi-rent.

    Obviously, both these uses of economic rent must be distinguished from the monthly rent payment made by a tenant to a landlord. In this case, rent is merely a term used to refer to the payment for a specific bundle of rental services (i.e., price times quantity of standardized quality constraint rental services).

    Such payments for rental services may or may not contain an element of economic rent in the sense of a payment to a factor of production over and above its minimum supply price. If the landlord is earning a rate of return above his opportunity cost -- the rate of return on the next best opportunity foregone -- then the rental payment includes an element of economic rent.

29. The professions themselves often make it very difficult for consumers to acquire information about the price and other charactericstics of the services they provide. On the legal profession's control over advertising, see Stanbury (1983) and the papers in Evans and Trebilcock (1982), e.g., Evans and Wolfson (1982) and Trebilcock (1982). See also Hudec and Trebilcock (1982).

30. See the discussion in Trebilcock et al. (1979) who refer to the problem of "protecting vulnerable interests."

31. Generally, see Trebilcock et al. (1979) and Professional Organizations Committee (1980).

32. The various types of contracting relationships are discussed in Williamson (1979). The important point is that neoclassical micro-economic theory assumes that all transactions (contracts) are anonymous, discrete rather than continuous and that all the relevant information is conveyed in the price. See note 35 below and Macneil (1978).

33. Transaction costs are analogous to barriers to trade. Comparative advantage, and differences in preferences means that there are gains from trade up to some point, i.e., equilibrium. However, when transaction costs are present they inhibit trades at the margin that, in their absence, would make both parties better off. Therefore, the presence of transaction costs prevents the attainment of an equilibrium that is Pareto-optimal as there are unexploited gains from trade that cannot be obtained by reason of the "barrier" of transaction costs.

34. Dahlman's (1979) analysis seems to imply that the only true market failure is the existence of imperfect knowledge. If transaction costs were absent, all the others could be reduced by bargaining to the efficient level. But transaction costs themselves are not a form of market failure. See section 8.4 below.

35. Neoclassical microeconomics implicitly assumes that economic transactions (contracts) are:
    - fully specified and certain;
    - discrete (all elements of the exchange are encompassed in a single transaction; there is no on-going relationship between buyers and sellers; each transaction is independent of each other); and
    - anonymous -- all that matters is whether the price is paid and goods handed over.

    In reality, we know that:
    - uncertainty is pervasive, but all contingencies cannot be specified in advance;
    - buyers and sellers have "memories";
    - some types of exchanges are almost continuous rather than discrete;
    - there is the possibility, because of imperfect knowledge and asymmetries in the relationship between transactors, for actors to behave opportunistically, i.e., self-interest seeking behaviour with guile; and
    - all exchanges are not anonymous.

36. The balance of Williamson's (1979) article is devoted to this task.

37. More generally, see Ouchi (1980), Jones (1984) and Williamson (1975).

Chapter 3

GOVERNMENT ACTION TO ALTER THE DISTRIBUTION OF INCOME, WEALTH, OR CONSUMPTION OPPORTUNITIES

> "In general, the art of government consists in taking as much money as possible from one class of citizens to give to the other" (Voltaire).

1.0 INTRODUCTION

1.1 The Importance of the Desire to Redistribute Income

People have strong feelings about "who should get how much of what" in the economy. These feelings translate into the normative bases of using the power of governments to try to alter the distribution of income, wealth or consumption opportunities produced by the combination of market forces and the distribution of original endowments. Indeed, it has been argued that more government intervention is attributable to the desire to alter the distribution of income than it is to improve allocative efficiency. See Stanbury and Lermer (1983) and Trebilcock et al., 1978. The desire to redistribute income may be purely selfish (to increase one's income at the expense of another's) or it may be predicated on more widely-shared values concerning the appropriate distribution of rewards in society.

The redistribution ethic is deeply entrenched in the set of ideas that shape public policy in Canada (Hardin, 1974). Doern and Phidd (1983, p. 571) identify as one of the "overriding challenges to Canadians" in the 1980s and beyond, the genuine redistribution of income so as to achieve greater equality. The panopoly of programs whose stated design is to redistribute income have

"not redistributed resources between rich and poor in a significant way". In their view, "the Canadian social fabric cannot withstand a decade of postponed redistribution while worshipping only at the alter of efficiency" (p. 572). At the same time, "major steps to improve efficiency are concurrently necessary and indeed unavoidable". Doern and Phidd (1983, p. 572) argue that this will require "immense amounts of honest public debate, high levels of social trust, and interaction, and major institutional reforms".

Nozick (1974, p. 232) suggests that "the legitimacy of altering social institutions (including the distribution of income and wealth) to achieve greater equality of material condition is, though often assumed, rarely argued for." While the "legitimacy of altering social institutions" may not be explicitly addressed in the normative literature on income distribution, there are myriad arguments why it is desirable for government to act to alter distributive outcomes. Overwhelmingly, such arguments favour a more egalitarian distribution of income, wealth or consumption opportunities. Egalitarianism is an extraordinarily powerful idea. Indeed, in a democracy, it seems there cannot be too much equality.

Robert Nisbet (1974, p. 103) argues that barring war or catastrophe, "the idea of equality will be sovereign for the rest of this century in just about all circles concerned with the philosophical bases of public policy". It has "all the requisites of becoming a religious -- a providential idea in our affluent age". Nisbet (1974, p. 105) goes so far as to argue that the strongest promoters of egalitarianism -- largely intellectuals -- are proclaiming "God is not dead; God is equality". Equality of opportunity, together with equality of basic rights, protected -- albeit imperfectly -- by constitutional law, are not enough. Both Nisbet (1974) and Bell (1972) argue that equality is now being interpreted, with the aid of Rawls (1971) and Jencks (1972) for example, as equality of result. The point is that concerns about equality have long since

gone far beyond the matter of political rights and have become focused on the distribution of income.

1.2 Basic Choices

Individuals face a fundamental choice in the task of maximizing their expected utility. They must decide how to allocate their energies between traditional economic markets and political markets. With respect to the former, they must decide whether to start a new business, create new products for an existing one, or find ways of becoming more efficient and thereby increase the returns on their financial capital. On the production side of the market, the role of most individuals lies in the supply of their own labour. Decisions on how to improve the income obtained from one's labour include determining the amount of investment in human capital by education or specialized training, and the decision as to which employer to work for in which location.

Alternatively, individuals may seek to change their own level of income or wealth by getting a government to alter the distribution of income produced by the market. They may seek government action in the form of tariff or non-tariff barriers, protective regulation or transfer payments of various types. They may even seek a patronage appointment that pays a generous salary. To obtain these benefits will require action (and the expenditure of resources) in political markets. Risks must be incurred, but success in obtaining government intervention can both increase the individual's income and reduce the riskiness of his environment.

The state has enormous powers to regulate, spend, tax, and purchase goods and services for the benefit of some individuals but not others.[1] In short, the state has enormous power to redistribute income.[2] While the concept of free enterprise and competitive markets may be philosophically attractive, it is of little comfort when the rigours of competition threaten both one's peace of mind and one's pocket book. There is considerable evidence to support the argument

that more and more people have chosen to act in political markets to raise their incomes -- even at the expense of a lower level of national income. Most of the positive theories of government action are based on the idea that individuals and groups seek to induce governments to act in ways that will improve their economic position (Stanbury and Thain, 1985; Hartle, 1983, 1984). For example, agricultural supply management marketing boards are sought by farmers in order to raise their income at the expense of the consumers of their products -- see Stanbury and Lermer (1983), and Lermer and Stanbury (1985).

Rational self-interested behaviour in the face of the fact that the allocative efficiency is a public good leads to political action to redistribute income in one's own favour.[3] The extension of the franchise, so that it is now virtually universal among adults, facilitates the process of using the government to alter the distribution of income, wealth or consumption opportunities just as the prior vastly unequal distribution of wealth serves to motivate efforts to obtain redistribution.[4]

1.3 The Means Count

Actions by government that are designed to redistribute income/wealth are almost ubiquitous. Many take the form of (*ex ante*) constraints on market forces rather than taxes and transfers imposed "after" the market has effected its allocation of resources. Stigler (1982, p. 14) suggests that the imposition of constraints on the free operation of supply and demand such as a price ceiling "is not an act of defiance against the law of demand. Rather, it is a decision based upon a preference for another system of assigning goods and distributing income." In fact, two issues are involved: the desire to alter the distribution of income that would be produced by market forces; and the fact that individuals have preferences concerning the process by which it is decided who gets what. In other words, the means the government uses to alter the distribution of income matter. As Evans (1982, p. 471) puts it, "in fact, recipients of

[government] transfers strongly prefer them to be tied to productive activity. Their welfare is lowered by direct transfers. Given this structure, regulation may well be the optimal redistribution device." On the use of regulation to redistribute income, see Stanbury and Lermer (1983).

The focus of this chapter is on the normative arguments for government actions to alter the distribution of income. In general, the means by which this is done are ignored in order to concentrate on the nature of the arguments in principle.

1.4 From Positive to Normative

Normative arguments for government intervention on the basis of economic efficency can be transformed quite easily into positive theories of government action. Here I note that positive theories based on distributional considerations can also be formulated as normative propositions. For example, Posner's (1971) "taxation by regulation" is a positive theory of government regulation, i.e., governments introduce direct regulation (price and entry controls) as a device to redistribute income among various classes of consumers who purchase the regulated product or service.[5] See Stanbury and Thain (1985).

Posner's positive theory can be reformulated as a normative approach to regulation by arguing that government ought to impose direct regulation so as to effect a redistribution among particular groups of customers. This should be done, for example, in order to ensure that "basic telephone service" is "universally" available because its low price makes it "affordable" to virtually every household. Moreover, it is argued, it is desirable to charge the users of long distance service more than twice what it costs to produce because most of them are businesses and they should pay a price that is commensurate with the "value of service" (potential economic benefits of the call) they receive.

1.5 Economic Theory and the Maximization of Social Welfare

It is important to distinguish between actions by government that may make the allocation of scarce resources Pareto optimal and those that maximize the welfare of society. When resources are allocated as efficiently as possible, i.e., Pareto optimality obtains, there is no way of making anyone better off without making at least one other person worse off. It should be emphasized, however, that the Pareto criterion rules out interpersonal comparisons of utility. Indeed, it was created by the distinguished sociologist Vilfredo Pareto precisely to address the problems associated with making interpersonal comparisons of utility. (See the discussion below.)

In addition to some fairly restrictive technical assumptions (see Bator, 1957), not the least of which is the existence of an equilibrium, a Pareto optimal position is defined in relation to some (given) set of original resource endowments, and some (given) distribution of such endowments. If these assumptions are changed, a different Pareto optima will be produced. How then do we determine if a change in the allocation or distribution of resources is a "good thing"? That is, how do we determine if it improves society's welfare? This requires the introduction, at least implicitly, of a social welfare function (SWF). A SWF is a mechanism for aggregating across the interests of individuals in society. As Evans (1982, p. 463) points out, "'ought' statements about economic policy can be interpreted as judgments about actions that will increase the social welfare function. 'Optimal' policy is defined as that which maximizes such a function." But as Evans (1982, p. 463) notes, the concept of a SWF itself necessarily incorporates a number of important value judgments. These include the following:

- Is the function to be based on the preferences/utility of individuals or upon man's interpretation of the Deity's preferences?

- If the SWF is to be based on the welfare of individuals, over what group of individuals is the function to be defined? Do the unborn count?
- What weights are to be assigned to the welfare of various individuals?
- What entities should be included in each individual's utility function? Should some goods, services or processes that provide utility/disutility to some individuals be "ruled out"? Do we include preferences for heroin, for example?
- How do we handle interactive utility functions of individuals? A mother's utility may depend on the level of education of her children or the children's system of personal values. As Evans (1982, p. 465) remarks, "values are placed on collective perceptions -- military strength, athletic fitness [think of the 1984 Olympics], godliness".

In practical terms, a SWF requires some explicit -- or more likely, implicit -- value judgments about the relative "deservingness" of different individuals. When these are incorporated into the analysis, society's welfare can be increased both by improving the allocation of resources and by altering the distribution of income (see Bator, 1957; Sen, 1970). Indeed, it may be possible to improve society's welfare by reducing allocative efficiency and simultaneously altering the distribution of income. However, it is one thing to make such value judgments; it is quite another to find widespread agreement for them. This may explain the great variety of normative arguments over why government should act to make the distribution of income more egalitarian.

On the grounds that it is impossible to find agreement upon the relative deservingness of individuals, and because, it is argued, some individuals should not have the power, via the state, to take from others for their own benefit, some people insist that the Pareto criterion be applied. To this point Evans (1982, p. 465) replies, "in practice, insistence on the Pareto criterion, or non-comparability of utilities across persons (the 'moral monstrousness' of

sacrificing one person's interests for other's) amounts to denial of the legitimacy of any economic policy at all". The reason for this is because most policy actions, even if they improve allocative efficiency, make some individuals better off and others worse off. In order to deal with some of these cases, the Kaldor-Hicks criterion was proposed. It holds that a policy action should be undertaken where, in principle, the "winners" could compensate the "losers" and still have something left over. As has frequently been pointed out, this approach might command considerable support if compensation was actually paid, and if transaction costs did not absorb the surplus, and if money could indeed fully compensate the losers for their assessment of their losses. Since these conditions do not hold, the problem remains. Therefore, implicitly or explicitly we must make judgments concerning the relative deservingness of individuals if we are to draw conclusions about how a particular action will affect society's welfare.

I now examine some of the arguments for altering the distribution of income as determined by market forces and original endowments.

2.0 UTILITARIANISM

2.1 The Greatest Good for the Greatest Number

The utilitarian perspective holds that society, hence governments, should seek "the greatest happiness of the greatest number". By this phrase Jeremy Bentham meant simply that the more good there is in the world the better, and since every human being counts as one (and only one), the more widely good is distributed the better (Hospers, 1972, p. 199). When translated into income distribution, utilitarianism can be the basis of statements such as "extreme inequalities [of income or wealth] reduce the overall happiness of mankind" (Page, 1983, p. 3).

In 1883 the English utilitarian Henry Sidgwick, referring to Bentham, argued that "the more society approximates to equality in the distribution of wealth among its members, the greater on the whole is the aggregate of satisfaction which the society in question derives from the wealth it possesses" (cited in Breit, 1974, p. 5). Stanley Jevon's contributions on marginal utility prompted the distinguished economist Edwin Cannan in 1902 to argue that a normative proposition was now grounded on positive science: "Moralists and Statesmen have long seen the evils of great inequality of wealth, and now, thanks to modern discoveries in economic theory, the economist is able to explain that it is wasteful" (as quoted in Breit, 1974, p. 5). Thirty years later, Pigou (1932) argued that "'the law of diminishing marginal utility' ... leads securely to the proposition: any cause which increases the absolute share of real income in the hands of the poor, provided that it does not lead to a contraction in the size of the national dividend [GNP] from any point of view, will, in general, increase economic welfare". For Pigou (1932, p. 89), it was evident that "any transference of income from a relatively rich man to a relatively poor man of similar temperament, since it enables more intense wants to be satisfied at the expense of less intense wants, must increase the aggregate sum of satisfactions".

2.2 Can We Make Interpersonal Comparisons of Utility?

However, it was also in 1932 that Lionel Robbins published his An Essay on the Nature and Significance of Economic Science. In it he argued persuasively that scientific economics could not be used to justify statements about the desirability of particular distributions of income/wealth. The crux of his argument is that individuals cannot make, on any scientific basis, interpersonal comparisons of utility/satisfaction. As a result, says Breit (1974, p. 7), "the idea that redistribution of income was a scientifically grounded policy lingered on only in the economic underworld". However, as Breit points out, Abba Lerner

in his book The Economics of Control (1944) sought to overcome Robbins' injunctions in "one of the most remarkable analytical feats in economic science" (Breit, 1974, p. 8). However, Lerner's Achilles heel is that his "analysis rests on the implausible idea that incentives are not affected by the redistribution; that the income being divided has been received by chance and is in no way related functional distribution" (Breit, 1974, p. 9). Therefore, if one finds these assumptions unacceptable, the force of Robbins' criticisms is unabated.

2.3 Utilitarianism and Income Equality

Page (1983, p. 5) asserts that "if we are willing to accept a few assumptions ... utilitarian reasoning leads to advocacy of complete equality [in the distribution of income]". What are these assumptions? First, we must accept the utilitarian postulate of the desirability of achieving the greatest good for the greatest number. Second, we must be willing to make interpersonal comparisons of utility. Third, we must assume that there is diminishing marginal utility for money. Fourth, we must assume that a given amount of money can purchase the same amount of happiness for each individual, although it may be spent in vastly different ways. Sixth, it must be assumed that the total amount of income available for distribution is fixed.

Regarding the matter of interpersonal comparisons of utility, Page (1983, p. 6) rejects the typical economist's unwillingness to make such comparisons.

> To refuse to compare the happiness of different individuals even in principle is virtually to refuse to make evaluations of income distributions and, in effect, to accept whatever the status quo may bring. It is also to shut one's eyes to a form of judgement we make every day. Sympathy and imagination, important human virtues, are both based on putting ourselves in another's place and comparing the other's happiness with our own. Most of us are convinced that the poor are less happy than the rich because we know we would be miserable in their circumstances.

As a practical matter, however, the last assumption -- that the total amount of income available for distribution is fixed -- may be the most important. In the real world it seems clear, although the precise relationship is not known, that the total volume of output is influenced by the way that it is distributed. In other words, it may be that a more egalitarian distribution will not maximize the total amount of income produced although it may improve society's welfare. Page (1983, p. 7) points out that "under these circumstances, even Rawls 'maximin' criterion [see section 6.6] would dictate some tolerance of inequality in order to maximize the welfare of the least well off."

The interesting thing about the utilitarians such as Bentham and Mill is that they did not specify what to do if the objective of the greatest possible amount of happiness was met with a substantially unequal distribution of income or wealth. Obviously, this clashes with the powerful idea of justice as equality of treatment. The conflict may be "resolved" if we take into account the problem of incentives of wealth creation. It may be that to stimulate the kinds of behaviour that increase wealth by the greatest amounts, it is necessary (in a functional sense) to offer substantially unequal rewards to individuals. For some persons, however, the resulting distribution of income/wealth will be sufficiently unacceptable that they will prefer a lower total wealth for society in order to achieve a less unequal distribution of that wealth.

3.0 MEETING BASIC HUMAN NEEDS

It is frequently argued that governments should redistribute income in order to ensure that everyone -- regardless of their ability, effort or even deservingness -- has sufficient income to meet their "basic human needs" such as food, clothing and shelter.

Redistribution of income in order to satisfy basic human needs is probably based on the idea that "the social conscience is more offended by severe

inequality in nutrition and basic shelter, or in access to medical care ["the necessities of life and health"] or to legal assistance, than by inequality in automobiles, books, clothes, furniture, boats" (Tobin, 1970, p. 265). Thurow (1981, p. 155) remarks that "ethically we have been committed for many centuries to the idea that a 'good' society does not let families starve on the street. With this commitment comes the responsibility for providing a minimum family income if the family is, for whatever reason, unable to take care of itself."

The Fabians offered a needs-based argument in favour of at least a minimal welfare state in which the government provided every citizen with goods, services and opportunities deemed essential to a decent way of life. Gutmann, (1980, pp. 70-71) summarizes the Fabians' perspective as follows:

> Given that adequate shelter and sustenance are universal prerequisites to happiness, that each person's happiness counts equally, and that the marginal utility of income and wealth progressively diminishes, then the satisfaction of the basic needs of the poor ought to have priority over the satisfaction of the desires of the rich.

The Fabians argued that the free market, given the initial distribution of resources produced a vastly unequal distribution of income/wealth. It was so unequal that it undermined the realization of human equality and the dignity of every person, for they observed that "millions of ... fellow creatures ... sweat and suffer in hopeless toil and degradation." The Fabians' case for socialism began with what they saw as the obvious need to ensure that everyone has the basic necessities of life. At the very least, government action is justified to prevent "destitution" which was defined by the Webbs as "the condition of being without one or other of the necessaries of life, in such a way that health and strength, and even vitality, is so impaired as to eventually imperil life itself" (cited in Gutmann, 1980, p. 72.). They recommended government action to attack the sources of "primary poverty": unemployment, poor medical care, inadequate child-care services, poor education and insufficient provision for old age.

Perhaps the most well known exponent of the "needs" approach to government action to redistribute income is Bernard Williams (1962). In the case of medicare, for example, he has argued that "leaving aside preventative medicine, the proper ground of distribution of medical care is ill health: this is a necessary truth." However, wealth or a certain level of income is necessary in order to purchase treatment. Therefore, those whose needs are the same will not receive the same treatment. This he describes as an "unnatural state of affairs." It is an easy leap, by his logic, to advocate government action to see that where such important needs exist they are met.

Nozick (1974, p. 234) states that Williams' argument amounts to the claim that "society (that is, each of us acting together in some organized fashion) should make provision for the important needs of all of its members."[6] Of course this is not a new proposition. It ignores, however, "the question of where the things or actions to be allocated and distributed come from" (Nozick, 1974, p. 235). In Nozick's view, Williams ignores the rights of those whose holdings are to be reduced to finance the basic needs of the poor.[7]

Tobin (1970, p. 264) distinguishes between "specific egalitarianism" and "general egalitarianism." The former is based on "the view that certain specific scarce commodities should be distributed less unequally than the ability to pay for them. Candidates for such sentiments include basic necessities of life, health and citizenship." General egalitarianism, on the other hand, is concerned with the distribution of income and wealth. Tobin (1970, p. 264) remarks, "while concerned laymen who observe people with shabby housing or too little to eat instinctively want to provide them with decent housing and adequate food, [many] economists instinctively want to provide them with more income." This statement epitomizes the conflict over rent controls as a means of ensuring that low-income households obtain "affordable housing" -- see Stanbury (1985).

Closely related to the idea that redistribution is justified/desirable to ensure that everyone's "basic human needs" are met, is the idea that redistribution should be undertaken to alleviate poverty: a condition of having insufficient funds to maintain a (socially) acceptable standard of living (Osberg, 1981, p. 53). I now turn to this argument for government action to alter the distribution of income.

4.0 ELIMINATING/AMELIORATING POVERTY

Sowell (1981, p. 35) argues that most people are concerned with the idea of poverty, not the distribution of income: "they are anxious that children should not go to bed hungry, that families should not live in leaky, rat-infested homes. They are saying that there is some minimum standard of material living that should be enjoyed by all members of the society. The precise level of that standard can be and is debated; the general goal is quite clear."[8] Sowell also argues that the public does not worry about what share of total income goes to which quintile or decile. He goes even further to say "even the poor are unconcerned about redistribution to equalize incomes" (Sowell, 1981, p. 36).[9] In his view,

> problems arise because some individuals -- typically intellectuals, politicians, and journalists -- are concerned with eliminating what they call "disparities" or "inequities" in the distribution of income, wealth, or economic power. Politically, this group of redistributionists promotes its goals by playing on the public's concern over poverty and its alleviation (Sowell, 1981, p. 36).

In Sowell's (1981, p. 42) view, the "basic conception of poverty is the existence of people who are below some given [apparently absolute] standard of living over some substantial period of time."[10] A major problem arises when the definition of poverty is frozen in statistics and then, in some cases, incorporated into legislation. The "causes" of poverty, whether examined at the

interpersonal level between regions, or between nations, are not well understood. "In the area of race, there are many heavily moral factors that are assumed to be heavily important causal explanations of poverty. Yet very little effort has been made to actually test whether that is so or not"[11] (Sowell, 1981, p. 45).

While many schemes aimed at the redistribution of income and wealth are justified in the name of ameliorating poverty, Sowell (1981, p. 50) has concluded that "the most productive thing the (United States) government could do is to stop making things worse" for the poor.

Bane and Jencks (1973, p. 3) offer a quite different concept of poverty, stressing relative rather than absolute deprivation:

> ... poverty is a condition of relative rather than absolute deprivation. People feel poor and are poor if they have a lot less money than their neighbors. This is true regardless of their absolute income. It follows that we cannot eliminate poverty unless we prevent people from falling too far below the national average. The problem is economic inequality rather than low incomes.

With respect to education, for example, they have concluded that "equalizing opportunity will not do very much to equalize results ... hence it will not do much to reduce poverty" (p. 4). In their view, official measures based on absolute standards fail to appreciate the perception that despite rising average affluence, many Americans see themselves as poor "both by their own standards and their neighbours'."

> Public opinion surveys show, for example, that when people are asked how much money an American family needs to "get by", they typically name a figure about half what the average American family actually receives. This has been true for the last three decades, despite the fact that real incomes (incomes adjusted for inflation) have doubled in the interval. (Bane and Jencks, 1973, p. 4)

They argue that the "cost of living" is "not the cost of buying some fixed set of goods and services. It is the cost of participating in a social system. It therefore depends in large part on how much other people habitually spend to

participate in the system." In their view, "people with incomes less than half the national average will not be able to afford what "everyone" regards as 'necessities'."

What conclusions follow for public policy? Bane and Jencks (1973, p. 5) argue that "the only way to eliminate poverty is ... to make sure everyone has an income at least half the average." This would appear to imply that the distribution of income be made much more egalitarian, hence, the fraction of the population that is poor, according to their definition, is made much smaller. Or, it suggests that the distribution of income be truncated by massive transfers for the lowest income recipients.[12]

In addition to using the existence of and concern for poverty (often ill defined), and the poverty of specific groups (the aged, depressed regions, disadvantaged minorities),[13] general redistribution -- in Sowell's view -- has been promoted by attacking the justification for the existing pattern of income payments. Sowell (1981, p. 37) notes that redistributionist arguments are often based on rewarding people for equal status when "the more fundamental question is whether decisions ought to be based upon any status rather than an assessment of behaviour." If income is to be based on status, "then some small group of people must decide on what that status is and they must then confer that status on, or deny it to millions of other human beings" (Sowell, 1981, p. 38). The literally hundreds of categorical government programs, which provide transfers or valuable services in kind is mute testimony of the status approach to income distribution/redistribution. Status in such cases is assigned in terms of the ascriptive characteristics of groups (e.g., age, physical disability, income) rather than the observable behaviour of individuals.

5.0 THE PRESUMPTION OF EQUALITY

A fundamental argument for a more egalitarian distribution of income is based on the simple, but powerful, presumption of equality. Berlin (1961, p. 131) argues that "no reason need be given for ... an equal distribution of benefits -- for that is 'natural' -- self-evidently right and just, and needs no justification, since it is in some sense concerned as being self-justified." He continues, "The assumption is that equality needs no reasons, only inequality does so; that uniformity, regularity, similarity, symmetry, ... need not be specially accounted for, whereas differences, unsystematic behavior, changes in conduct, need explanation and, as a rule, justification."

Hospers (1972, p. 345) notes that "there is no doubt that in daily life we associate the idea of justice with that of equality," in particular, equality of treatment. Is it true, for example, that there are some things that all men are equally entitled to, regardless of their rank or station in life, which it would be unjust for everyone not to have? For example, is it unjust for a few to eat caviar as a prelude to a large meal when there are many others without bread? (Recall the discussion in section 3.) Hospers (1972, p. 35) argues that while the previous propositions may enjoy wide support, "nothing could be more ridiculous than to provide everyone with an equal number of each kind of material thing." Rights aside, "in any possible scheme for equal distribution, money is about the only thing we can distribute, because people can satisfy so many, though not all, of their desires with it." (Hospers, 1972, p. 352).

The presumption of equality may be buried in elaborate efforts to deduce it as a result of a complex "moral geometry." Such is the case in John Rawls' book, A Theory of Justice. Rawls' (1971) general conception of social justice or the social ideal is that "all social primary goods -- liberty and opportunity, income and wealth, and the bases of self respect -- are to be distributed equally unless an unequal distribution of any or all of these goods

is to the advantage of the least favored." (Rawls' views are discussed in more detail below.)

Frankel (1973, p. 57) notes that in this highly praised work, "inequality as such is in the defendant's seat. Equality comes to the bar with every presumption of innocence on its side." Professor Rawls, he says, "takes it for granted that if income and wealth are equally distributed no questions need to be asked, but if there are inequalities the institutions of society should be indicted and brought to trial." Nisbet (1974, p. 107) argues that Rawls' book "can be regarded as the long-awaited successor to Rousseau's Social Contract, and as the rock on which the Church of Equality can properly be founded in our time."

Lucas (1980, p. 169) indicates that "justice is sometimes said to be the same as equality. This is a mistake. Justice is connected with equality, and sometimes arguments for justice lead to egalitarian conclusions, but justice is not identical to equality, and can run counter to it." For example, the judge that found guilty all the accused brought before him, sentencing all to the same punishment would be treating everyone equally, but hardly justly.

In Hayek's (1976, p. 81) view, "the postulate of material equality would be a natural starting point only if it were a necessary circumstance that the shares of different individuals or groups were in such a manner determined by deliberate human decision." But such is not the case in the spontaneous impersonal workings of a competitive market economy. In short, desert or deservingness has nothing to do with it. "The prevalent demand for material equality is probably often based on the belief that the existing inequalities are the effect of somebody's decision" (p. 81). The irony is that as the role of the state expands, often in response to the demand for "distributive justice," the presumption is true. That is, government action deliberately

alters the distribution of income and hence it is seen as being responsible for such changes.

The assumption of equality, for some, has led to the idea that equality should consist of equality of result. The logic of equality of result, following Jencks (1972), is as follows: since the factors that make for success such as luck, genetic endowments, family characteristics, are simply wayward, there is no ethical justification for large disparities in income and status; since one cannot equalize these factors in order to create equal opportunity, one should seek to equalize results (adapted from Bell, 1972, p. 47). At no place do the new egalitarians (e.g., Jencks, Rawls) address the matter of individual effort or work. Yet even the most severe critics of government transfer programs usually support payments to families where the adults mke every effort to work to support themselves.

6.0 JUSTICE AS FAIRNESS

6.1 The Importance of Rawls' Work

John Rawls' book, A Theory of Justice, published in 1971, has had a major impact in its own discipline, philosophy, and in a wide range of other disciplines from psychology to economics to public administration. It also met with wide popular approval.[14] Even when roundly criticizing Rawls, other scholars praise his contribution.[15] Schaefer (1979, p. 5) suggests that the enormous positive reaction to "a 607-page work of abstract and often heavy-handed prose" is in part based on Rawls "supplying a theoretical, philosophical justification for the political beliefs that many well-intentioned men have previously held without much support." Those beliefs include a more egalitarian distribution of income and consumption opportunities. In a sense, Rawls provides a complex moral geometry to produce principles by which we ought

to solve the problem of distribution. That is why his work merits a fairly extended discussion.

6.2 Rawls' Purpose

Rawls (1971, p. 9) states that his purpose is to provide principles of social justice that will provide "a standard whereby distributive aspects of the basic structure [of society] are to be assessed." For him, "Justice is the first virtue of social institutions, as truth is of systems of thought" (Rawls, 1971, p. 3). Nisbet (1974, p. 110) challenges Rawls' assertion concerning "our intuitive conviction of the primacy of justice." If there is a single virtue sovereign over all others, he says it more likely to be "protection or security, followed closely by conservation (in the sense of perpetuation of norms and ways of life)."

Rawls claims to have developed certain principles of justice about the basic structure of society (he specifically rules out micro decisions) that are superior to previous theories from a position that represents generally shared or weak conditions. It behooves us, therefore, to examine Rawls' concept of justice as fairness, for he has sought to devise a moral theory that will be more appealing than utilitarianism, perfectionism, and intuitionism, all of which he criticizes.[16]

6.3 Reasoning From the "Original Position"

Because justice means fairness, and the essence of fairness for Rawls is equality, Rawls begins not with the "state of nature as do many philosphers," but with a rather unusual and abstract "original position". From this position individuals are to unanimously agree upon certain principles of justice that shall prevail in the design of social institutions generally. As Schaefer (1979, pp. 26-28) and others points out, the original position represents a remarkable bundle of assumptions. Men have their own life plans, their own conceptions of the good, but they take no interest in each other's interests and

at the same time they are to choose principles of justice behind a "veil of ignorance." Simultaneously, in order "to nullify the effects of special contingencies which put men at odds and limit them to exploit social and natural circumstances to their own advantage" in an unjust way, Rawls (1971, p. 137) assumes that no one in the original position "knows his place in society, his class position or social status, ... his fortune in the distribution of natural assets and abilities, his intelligence, and strength, and the like." The likely implications are clear, for as Zeckhauser (1970, p. 109) remarks, "Is it not the case that if none of us knew our future position in society that we would have agreed to a redistribution scheme from the more to the less fortunate?" This is true particularly wher people are risk averse.

While having individual life plans and concepts of the good, each person is <u>not</u> aware of them; yet they are assumed to "know" the general facts about human society in the original position. They understand political affairs and the principles of economic theory; they know the basis of social organization and the laws of human psychology" (Rawls, 1971, p. 137). Envy, however, is absent. Why?

Nisbet (1974, p. 113) argues that persons in Rawls' original position "sound exactly like the confined neurasthenic Proust described in <u>Rememberance of Things Past</u>: able endlessly to discuss and debate monumental abstractions, but helpless when it came to the simplest duties of ordinary existence." Rawls (1971, p. 141) admits that "we want to define the original position so that we get the desired solution." In this, Nisbet (1974, pp. 110-113) states that Rawls is a <u>philosophe</u> rather than a philosopher. He is simply trying to prove the rightness of a given set of values he has already arrived at.

In Rawls' framework each individual is given an "index of primary goods" (rights and liberties, powers and opportunities, income, and wealth, and self-respect) with which to judge principles of justice (Rawls, 1971, pp. 92-93,

396). Primary goods are those that any rational person would want more of rather than less for the attainment of his particular concept of the good.

6.4 Two Principles of Justice

The rational, self-interested behaviour of men in the original position, says Rawls, would lead them to agree on the following two principles of justice:

(1) "Each person is to have an equal right to the most extensive total system of equal basic liberties compatible with a similar system of liberty for all." This principle is to be accorded priority, i.e., liberty can be restricted only for the sake of liberty, but not for the sake of any other good, e.g., wealth or income.

(2) Social and economic inequalities are to be arranged so that they are both (a) to the greatest benefit of the least advantaged, consistent with the just savings principle (p. 289), and (b) attached to offices and positions open to all under conditions of fair equality of oppurtunity (Rawls, 1971, p. 302).

Rawls (1971, p. 61) defines the equal basic liberties as "roughly speaking, political liberty (the right to vote and to be eligible for public office) together with freedom of speech and assembly; liberty of conscience and freedom of thought; freedom of the person along with the right to hold (personal) property; and freedom from arbitrary arrest and seizure as defined by the concept of the rule of law." However, he does not define what is meant by "a fair equality of opportunity." It is obvious, however, that the term is evocative and consonant with popular notions of egalitarianism. Although the principle of liberty (#1) is made prior to all else, including equality, it "is utterly outweighed in mass and use by the second principle," which is "consecrated to as radical a form of egalitarianism as may be found anywhere outside the pages of the Social Contract" (Nisbet, 1974, p. 114).

6.5 The Difference Principle

Rawls deduces from his two fundamental principles of justice what he calls "the difference principle." This is the heart of his message. It provides that all social primary goods must be distributed equally throughout a society unless an unequal distribution of any of these goods is to the advantage of the least favored. It should be emphasized that the most important result of Rawls' elaborate reasoning is that the end of social justice is to arrange the basic structure of society to maximize the worth of the least advantaged within a scheme of "equal liberty shared by all" (Rawls, 1971, pp. 204-5).

Nozick (1974, p. 190) asks why the difference principle focuses on groups rather than the worst-off individuals. Moreover, which groups are to be considered? Rawls suggests, as does Bane and Jencks (1973), that the least advantaged may be defined as all persons with less than half the median income and wealth. This formulation, in Rawls' view, "has the merit of focusing attention on the social distance between those who have the least and the average citizen." He ignores the fact that the distribution of income and of wealth are substantially different (see Osberg, 1981).

Rawls (1971, p. 158) states that "the difference principle ... presupposes ... a certain theory of social institutions ... It relies on the idea that in a competitive economy ... with an open class system excessive inequalities will not be the rule. Given the distribution of natural assets and the laws of motivation, great disparities will not long persist." At the same time, he acknowledges the same principle "permits indefinitely large inequalities in return for small gains to the less favoured" (Rawls, 1971, p. 536). This theoretical point is ignored by virtually all of those who endorse Rawls' principles of justice.

6.6 The Maximin Criterion

In Rawls' view (1971, p. 152), his two principles are "the maximin solution to the problem of social justice," which "tells us to ... adopt the alternative the worst outcome of which is superior to the worst outcomes of the others." Why is it rational to adopt this game theory criterion (maximin)?[17] Because, "in the original position behind the veil of ignorance," each person must assume, according to Rawls, that their place in society will be determined by a "malevolent opponent." Why must they do so?

Schaefer (1979, p. 33) offers two trenchant criticisms of Rawls' conclusions that the maximin is the only rational criterion to apply. First, he notes that Rawls (1971, p. 137) ruled out knowledge of one's own risk-taking propensity in the original position and that the maximin criterion is the best one to adopt where the individual is risk averse and opponents are assumed to be hostile. Second, Rawls (1971, p. 144) has previously denied that the individuals in the original position are envious of each other or harbour feelings of hostility. Schaefer (1979, p. 34) concludes that "Rawls' own preference for the maximin rule appears to represent nothing more than personal timidity."

6.7 Policy Concerning Natural Endowments

It is one thing to argue that social justice requires that social and economic inequalities ought to be tolerated only so long as they provide the greatest benefit to the least advantaged group in society, it is quite another to regard differences in genetic endowments and natural talents as a kind of common property resource to be managed by the state for the benefit of the least advantaged. Yet Rawls does precisely this. Hence, Rawls proposes to go far beyond equality of opportunity for talents and desires in the name of justice as fairness.

For example, Rawls (1971, p. 102) argues that "no one deserves his greater natural capacity nor merits a more favorable starting place in society." Indeed, Rawls views "the distribution of natural talent as a common asset" and that the difference principle, in effect, constitutes an agreement to "share in the benefits of this distribution whatever it turns out to be." These differential capacities need not be eliminated, for example, by state action -- as if that were possible. Instead, argues Rawls, "the basic structure can be arranged so that these contingencies work for the good of the least fortunate."

Rawls (1971, p. 104) simply states that the notion of desert does not apply to natural endowments and leaves it at that. Yet he (1971, p. 310) accepts that "there is a tendency for common sense to suppose that income and wealth, and the good things in life generally, should be distributed according to moral desert." But Rawls (1971, p. 313) takes desert to be "a just scheme [that] gives each person his due, that is, allots to each what he is entitled to as defined by the scheme itself". As Schaefer (1979, p. 55) comments, Rawls has defined desert "so that it will mean nothing other than 'what accords with Rawls' two principles'."

6.8 Rawls and the Distribution of Income

Will the decision making process in the original position behind the veil of ignorance tend to result in an egalitarian distribution of income? Nozick (1974, p. 198) believes that it would. He puts it this way: "Imagine a social pie somehow appearing so that no one has any claim at all on any portion of it, no one has any more of a claim than any other person; yet there must be unanimous agreement on how it is to be divided. Undoubtedly, apart from threats or holdouts in bargaining, an equal distribution would be suggested and found plausible as a solution." Gutmann (1980, p. 129) observes, "if the difference principle does not work in the direction of equalizing shares, it is unlikely that anything short of a principle of strict equality will." Rawls (1971, p.

157) himself envisaged this result from the application of his principles: "The disparities likely to result will be much less than the differences men have often tolerated in the past."

Suppose, however, the size of the pie was not fixed and that it could be enlarged by pursuing an unequal distribution of income. Then there may be agreement to unequal shares, provided the position of the least advantaged were improved over the situation of equal distribution. Nozick (1974, p. 198) points out that this larger total pie depends on differential contributions. Shouldn't this fact of identifiable differential contribution lead to some differential entitlements?

6.9 Conclusions

Rawls' A Theory of Justice, in the end, is a "one-variable theory of the world" or at least of the fundamental values upon which we should erect society. As such, it suffers from undesirable and unnecessary abstractness, an air of unreality and, ultimately, almost total sterility. In making every other virtue subordinate to one virtue, the theory not only violates the tenets of moderation, but it also has within it the seeds of totalitarianism (see Nisbet, 1974). If Rawls' principles were put into practice, the social good would be defined by envious intellectuals who fail to appreciate that the vigorous application of their own "principles" will remove once and for all their anxiety about the desert of their own privileged positions. In that sense, more humble men can only desire that they get their wish -- but hopefully only for a short period for the sake of the rest of us.

7.0 EQUALITY AND MEANINGFUL CHOICE

Hospers (1972, p. 356) argues that there is a minimum level of instrumental goods (e.g., money, food) below which equality is useless because equality in virtually nothing is of no use to any of the recipients. Similarly, Page (1983, p. 3) argues that "liberty ... requires a degree of material equality" as "money

expands choices."[18] Gutmann (1980, p. 126) holds that "basic effective liberty" requires that medical and legal services be distributed on the basis of need and be made co-equal with Rawls' first principle of equal liberties for all. This is necessary because "certain basic human goods and services are prerequisites to the free and enjoyable use not only of all other goods but of basic liberties as well."

Page (1983, p. 3) goes even further when he asserts that "self-fulfilment and personal development also requires material foundations ... Creative thinking and aesthetic appreciation are not encouraged by an empty stomach or a desperate struggle for existence." Therefore, it is advanced that

> even the liberal notions of equality of opportunity and fair regard for individual achievement depend upon substantial equality of result ... The [competitive] race is supposed to be a fair one, in which the competitors have an equal start ... The children of past winners have big advantages in their own contests: inherited wealth, good nutrition, intellectual stimulation, and opportunities to learn skills and motivation from family and friends. (Page, 1983, p. 3)

Viner (1960, p. 47) emphasizes that "freedom" in the sense of freedom of choice is a sterile concept. In the absence of "economic resources, or of acquired knowledge and skills, or of the appropriate complexion ... subjective exercise of ... freedom of choice [is] little more than indulgence in wishful daydreaming." Therefore, in the sense that government action increases an individual's economic resources or knowledge or skills it is able to increase his freedom of choice. In other words, not all government action imposes constraints on the choice set of individuals. It may, under certain conditions, enlarge the set of available choices for some individuals. In doing so, however, it may also restrict the freedom of others. For example, the tax side of a tax-transfer program clearly alters the income/wealth of those paying the taxes to finance the transfers.

8.0 DESERVINGNESS OR DESERT

Justice is also getting what one deserves (see Lucas, 1980). The ideal may be thought of as a perfect apportionment between one's deserts and one's reward. But upon what basis is desert to be determined? Shall it be achievement -- in what sense? Shall it be effort? That may involve rewarding those who "work hard" (in some sense) but produce little of value. What about ability? But do we mean native (or inherited) ability, or do we mean acquired ability? What about desert based on <u>need</u>? But should the shiftless be provided with an income simply because they are needy? Should need be a purely private need? What about public or social needs?

The notion of desert is deeply and widely held. It is a central component in our concept of fairness as fairness is to justice. Yet it is extremely difficult to define and even more difficult to hold stable our concepts of "deservingness." The notion that may lie behind the hostility to "unconscionable" increases in rent is the feeling that exogenous shifts in demand that produce "windfall" gains for landlords are "undeserved" because they are "unearned," being largely attributable to chance -- see Stanbury (1985, Ch. 2). At the same time, many people feel that the losses attributable to "Acts of God" should be shared by society at large. That is why, in the United States, in the wake of a hurricane, the declaration of a "national disaster area" means that the federal government will compensate individuals for a large part of their losses.

Does the market reward people according to their desert? In perfectly competitive markets individuals will receive a wage equal to the value of their marginal product (see Osberg, 1981, pp. 69-72). But what if demand changes and there is almost no demand for horseshoe makers? Is it just that they should starve, or even be forced to learn a new trade more highly valued in the

market.[7] Should desert be based on the riskiness of an undertaking? High risks, it may be argued, deserve higher expected rewards.

Hospers (1972, p. 373) concludes that "justice is at odds with utility. If we want a system of rewards with maximum utility, we must to some extent sacrifice justice; and if we want a just system of distribution, we must to some extent sacrifice utility." See also Okun (1975). Rightness will be a function of both desert (the past) and utility (the future).

9.0 REDISTRIBUTION BY GOVERNMENT CANNOT BE JUSTIFIED

I have reviewed a number of normative arguments supporting government action to alter the distribution of income, wealth or consumption opportunities. It may be useful in bringing this chapter to a close to provide at least one counter-argument and to discuss the impact of governments' efforts to alter the distribution resulting from the combination of the distribution of original endowments and the operation of market processes. I focus on Robert Nozick's libertarian critique of government action to redistribute income.

Nozick (1974, p. 149) argues that "the minimal state is the most extensive state that can be justified. Any state more extensive violates people's rights." In his view, "individuals have rights, and there are things no person or group may do to them (without violating their rights). So strong and far-reaching are these rights that they raise the question of what, if anything, the state and its officials may do."

The focus of Nozick's argument is on the individual's supreme claim to liberty, from which the rights to life and to property follow. Other libertarian thinkers focus on the right to unfettered private property and from it derive the right to life and to liberty. The critical idea is that each person is the owner of their own life. As such, each individual, following Locke, has a right to act in accordance with their choices unless those actions

infringe upon the equal liberty of other persons to act in accordance with their choices. Gutmann (1980, p. 157) states "The Lockean libertarian maxim might ... become to each according to the fruits of his (successful or unsuccessful) efforts."

The entitlement conception of justice in holdings does not permit one to decide that the state ought to alter the distribution of income merely by examining the distribution of income/wealth: "It depends upon how the distribution of income came about" (Nozick, 1974, p. 232). If the distribution was the result of legitimate processes, then the individual's holdings are legitimate. They can only by reduced without violating people's entitlements -- the highest desiderata in Nozick's moral universe. Strong feelings about "distributive justice" stem, in part, from the perceived legitimacy of individuals' or groups' possession of property rights. Even the strongest believers in the inviability of individual rights recognize the role of the state in "rectifying obviously illegimate holdings of rights" (Anderson and Hill, 1980, p. 8).

Nozick (1974, p. ix) concludes that "a minimal state, limited to the narrow functions of protection against force, theft, fraud, enforcement of contracts, and so on, is justified; that any more extensive state will violate persons' rights not to be forced to do certain things, and is unjustified; and that the minimal state is inspiring as well as right."

In Nozick's (1974, p. 230) view, distributive justice based upon the principles of justice in acquisition and justice in the transfer of holdings, is no argument for a state more extensive than the minimal state.[19] He states that "the illegitimate use of a state by economic interests for their own ends is based upon a preexisting illegitimate power of the state to enrich some persons at the expense of others" (Nozick, 1974, p. 272). If the former illegitimate power were eliminated, the desire for political power would also wane.

Although he does not entirely rule out redistribution by government effected by non-distorting lump-sum taxes and transfers, Nobel Laureate F.A. Hayek too focuses on the primacy of individual liberty and the desirability of establishing conditions to facilitate a "spontaneous order." Moreover, redistribution in the name of "social justice" can have totalitarian implications as he points out.

In Hayek's view, the term "social justice" has become an all-justifying code word in the pantheon of those wishing to alter the distribution of income. Hayek (1976, p. 65) remarks, "Almost every claim for government action on behalf of particular groups is advanced in its name, and if it can be made to appear that a certain measure is demanded by 'social justice' opposition to it will rapidly weaken." The commitment to "social justice" is the chief outlet for moral emotion and signifies to others that the user of the term possesses a moral conscience. Hayek (1976, p. 66), notes that the most frequent users of the term cannot define it in any general sense, rather it is "simply a quasi-religious superstition ... which we must fight when it becomes the prefix for coercing other men." Hayek (1976, p. 7) is particularly critical of the belief in "social justice" because where it governs political action it will lead us toward a totalitarian system.

It need hardly be said that this result contradicts what Hayek and others see as the tenets of a free society in which the rule of law is used to facilitate the general good. This condition requires the maintenance of the conditions necessary for a spontaneous order in which individuals are able to provide for their own needs in a manner not known and not knowable, to public authorities. For Hayek, the market is an impersonal process that allocates resources which cannot be just or unjust, because the results are not intended or forseen. The reason the market should be as widely utilized as possible is that "it is the only procedure yet discovered in which information widely

dispersed among millions of men and women can be effectively utilized for the benefit of all -- and used by assuring to all an individual liberty desirable for itself on ethical grounds" (Hayek, 1976, p. 71). While it is logical to require that the rules under which the market "game" is conducted be fair, "it would be nonsensical to demand that the results for the different players be just. They will of necessity be determined partly by skill and partly by luck."

Hayek's central point is that the fewest possible constraints should be placed on market processes so as to permit them to allocate resources efficiently. As an information processing and signalling system to allocate resources it is without peer, particularly if individual liberty is the most important norm in society. People should not expect markets to be fair, only efficient and consonant with the greatest possible individual freedom of action. The impoication is that redistribution to reflect ethical preferences should not be effected by "fiddling" directly with market processes, but a system of taxes and transfers that minimize the distortion to the price system.

10.0 THE IMPACT OF GOVERNMENT ON THE DISTRIBUTION OF INCOME

It is one thing to argue for greater equality in the distribution of income or wealth, it is quite another to argue that a particular program of government intervention will actually contribute toward that end. Sowell (1981, p. 49) argues that "the fallacy of political reform as a solution to perceived social ills is that it ignores process and focuses only on results." He continues

> The most fundamental problem in political decision making is that we cannot vote for a result; we can only vote for a process. We can hope for the (desired) result from that process.

Despite the fact that transfers, for example, have grown enormously both in real terms and as a fraction of government expenditure (which has itself grown relative to GNP -- see Howard and Stanbury, 1984), the distribution of money income in Canada has changed very little in the past three or four decades.

Osberg (1981, p. 11) provides data indicating that the share of total income in Canada received by the lowest 40% of families and unattached individuals has remained virtually unchanged at about 15% between 1951 and 1978. The share of the top 20% was also almost unchanged at about 42% of the total. Osberg (1981, p. 11) remarks that "this constancy of income shares since World War II should be something of a surprise, since a great deal has happened in the Canadian economy in the last 30 years. Real per capita personal income has considerably more than doubled, the labour-force participation of married women has more than tripled, the number of families composed of only one person has increased by roughly 40 per cent and, recently, inflation has played havoc with money wage rates and the returns from different assets. All these factors could be expected to affect income shares."

As helpful as his list is, Osberg has left out the tremendous growth of government activity during the last three decades. For example, expenditures by all three levels of government in Canada -- in constant 1971 dollars -- increased from 26.5% of GNP in 1950 to 45.4% in 1982. Transfers to persons increased over the same period, from 7.1% of personal income to 13.9% (Howard and Stanbury, 1984). On the tax side of the fiscal agenda, Pipes and Walker (1984, p. 5) indicate that total taxes as a fraction of total income in Canada increased from 28.3% in 1961 to 44.4% in 1981. They calculated that all taxes as a fraction of the income before tax of the average Canadian family increased from 22.1% in 1961 to 33.2% in 1983 (p. 54). They show that the tax rate by deciles increased between 1961 and 1981 for the third through tenth deciles, was about constant for the second decile and decreased for those in the lowest decile (p. 66).

The tax and expenditure system are only a part of the efforts by government to redistribute income. Regulation, Crown corporations, loans and guarantees and "tax expenditures" are all used to alter the distribution of income. It

should not be assumed, however, that the general direction of redistributive activities is toward greater egalitarianism. [An analysis of the distributional results of rent control is provided in Stanbury and Vertinsky (1985, Ch. 6).] While there is some evidence to indicate that the impact of the social security system in Canada (in the early 1970s at least) favoured lower income families, the opposite is true of federal "tax expenditures" in the personal income tax.[20]

The problem, determining the distributional impact of government activity -- even that overtly designed to favour low income families -- is very hard to discern for two important reasons. First, as I have noted, many other changes are occuring in the economy simultaneously. It is all but impossible to "parcel out" the effects of different variables. Second, it is very difficult to determine the distributional impact of even one level of government ignoring all other variables.[21] After 200 pages of data, analysis and argument, Page (1983, p. 206) concludes that we know very little of who gets what from the federal government in the United States.

> We do not know, and probably cannot know, exactly who gets what from government. So many government actions affect the income distribution in such complex ways that it is virtually impossible to pin down precisely to what extent the U.S. (or any other) government contributes to -- or lessens -- income inequality.

The situation is not better in Canada as we do not have the raw material from which a book as detailed as Page's could be written. (But see the efforts by Gillespie, 1964, 1976, 1981.)

The net result of government activity appears to leave the distribution of income unchanged.[22] Why is this the case? It may be that the effect of government actions to alter the distribution of income do make it more egalitarian, but these changes are offset by other changes in the economy. For example, Thurow (1981, p. 160) argues that in the U.S., without government transfer payments, the share of income going to the bottom quintile of

households (between 1948 and 1977) would have been more than cut in half during the post-World War II period. "Government actions prevented this from happening and actually caused a substantial gain in the income position of the poor. Here again, making a correction for in-kind aid would make the gains even larger." In the case of the second and third quintiles, they were stopped from losing ground due to higher and increasing female labour force participation rates, but this force is declining. In general, Thurow (1981, p. 161) argues that "we are entering a period of rising inequality where conventional income transfer programs will be incapable of preserving the current degree of inequality."

There is also evidence that those who are not poor use the power of government to increase their incomes/wealth. They are, in short, successful "rent-seekers".[23] Page (1983, p. 213) states "biased pluralism or imperfect political competition sees corporations and organized groups with an upper income slant (exerts) political power over and above the formal one-man-one-vote standard of democracy." The third explanation, or structuralist view, also finds substantive support. It asserts that inherent features of a capitalist economy compel rational actors, even those of low income, to accept inequality for the sake of more material goods for everyone" (Page, 1983, p. 213). As Okun (1975) emphasizes, there is a tradeoff between equity and efficiency.

In the United States -- unlike Canada -- there are substantive constitutional protections against policies that might seek to effect a major redistribution of wealth. For example, the Fourteenth Amendment says that, "nor shall any state deprive any person of life, liberty, or property, without due process of law." The Fifth Amendment is even stronger. It provides that no person can "be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use without just compensation."

Page (1983, p. 197) argues that

> A requirement of just compensation whenever property is taken for public use would apparently rule out any massive redistribution of wealth or income by the states. A state can confiscate millionaires' assets for distribution to the poor only if it compensates the millionaires with equivalent assets, undoing the intended effect of the confiscation.

Notes to Chapter 3

1. On the nature, size and scope of government intervention in Canada, see Howard and Stanbury (1984).

2. The distributional impact of the U.S. federal government is discussed in Page (1983).

3. In trying to understand the subtleties of how to maximize the aggregate wealth of the nation, economists have failed to analyze the problem from the perspective of the individual. He usually has more to gain from actions in political markets (that often reduce allocative efficiency) than from his share of improvements in national income attributable to allocative efficiency.

4. It appears that the growth of government intervention is partly attributable to the extension of the franchise -- to those with lower income and to the less well-educated, to women and finally to persons as young as 18. Obviously, the distribution of the franchise (virtually universal for all persons 18 and over) is more equal than the distribution of income. The have-nots can obtain in political markets (assuming they can overcome information and organization costs and free rider problems) that which they cannot obtain in economic markets.

5. For example, in the case of telecommunications services long distance callers pay far more than the cost of providing voice toll calls while households obtain local exchange service at a price that is well below the cost of providing it. See Globerman and Stanbury (1985).

6. For another critique, see Gutmann (1980, pp. 98-105).

7. In her book, Atlas Shrugged, Ayn Rand offered the following emotional argument against need as the basis of claims on income and wealth as follows: "A morality that holds need as a claim, holds emptiness -- nonexistence -- as its standard of value; it rewards an absence, a deficit weakness, inability, incompetence, suffering, disease, disaster, the lack, the fault, the flaw -- the zero." Moreover, she goes on, "who provides the account to pay these claims?"

8. Sowell (1981, p. 35) distinguishes carefully between the "distribution of income" and "poverty". He argues that the term distribution of income is a misnomer: "income is earned, not distributed. It represents payment for services rendered personally or by one's property in the case of private property societies" (Sowell, 1981, p. 36). Sowell ignores, however, the fact that in Canada, for example, the value of government transfer paymens by all three levels of government now exceeds total exhaustive expenditures (Howard and Stanbury, 1984). Moreover, transfers including interest on the public debt now exceed one-quarter of personal income. Transfers to persons alone exceed one-eighth of personal income (Howard and Stanbury, 1984). This evidence suggests that an increasing fraction of personal income is not earned but is distributed in the form of unrequited payments by governments.

9. "Without question, ordinary working people tend to oppose equalizing incomes even if they would benefit from it" (Page, 1983, p. 53, citing Hochschild [1981].)

10. Thurow (1981, p. 18), on the other hand, argues that "there is no minimum absolute standard of living that will make people content".

11. See the thoughtful discussion in de Jouvenal (1952).

12. For a discussion of the relatively small amounts available on a per capita basis of even a 100% tax on those with "high" incomes, see Pipes and Walker (1984, pp. 28-9).

13. The same is true of sex differences whereby low average female earnings relative to males is taken as conclusive evidence of discrimination. Sowell (1981, p. 47) shows that if occupation, and marital status are taken into account, the differentials disappear or are reversed!

14. See the discussion in Schaefer (1979, pp. 3-6), Nisbet (1974) and Bell (1972).

15. See, for example, Barry (1973), Nozick (1974) and Wolff (1977). More generally, see Daniels (1975).

16. Kristol (1972, p. 42) argues, in effect, that Rawls' elaborate analysis is unnecessary. He states that Aristotle's definition of a just and legitimate society has not been improved upon, despite the efforts of countless philosophers: it is a society in which inequalities of property or station or power are generally perceived by the citizenry as necessary for the common good.

17. Wolff (1977, pp. 16, 103) argues that Rawls had one of the liveliest ideas in the history of social and political theory "when he hit upon the notion of using a game theory model of the social contract to show that substantive moral principles might be drawn from formal rules of choice".

18. Surely the statement should be "liberty requires financial resources to expand one's chances". The issue is resources in absolute not relative terms.

19. Nozick points out that even the minimal or night-watchman state appears to be redistributive. To avoid this possibility -- which violates individual rights -- he defines the "ultraminimal state" which he describes as follows:

> An ultraminimal state maintains a monopoly over all use of force except that necessary in immediate self-defense, and so excludes private (or agency) retaliation for wrong and exaction of compensation; but it provides protection and enforcement services <u>only</u> to those who purchase its protection and enforcement policies. People who don't buy a protection contract from the monopoly don't get protected. (Nozick, 1974, p. 26)

20. On the former, see Osberg (1981, p. 188); on the latter point, see Howard and Stanbury (1984).

21. Page (1983, p. 209) notes that

> A special difficulty in assessing the effects of government is that effects must be calculated relative to some counterfactual, some baseline model of what the world would be like without the government action. That is fairly manageable if we just want to judge the impact of a single tax or spending program: we can compare what the income distribution is like when the program is in place with what it would be like without the program, assuming everything else remains the same. (This is called "absolute incidence"; "differential incidence", relative to some similar program, is actually somewhat easier to compute.) But when we want to consider the impact of all programs at once, we are compelled to imagine a "no government" counterfactual -- a patent absurdity. It makes no sense to try to conceive of a modern industrial society functioning with no government at all because government is so closely interwoven with every economic activity.

22. Bell (1972, p. 64) suggests that judgements about fairness and public policy have not played a major role in reducing income disparities over the past 200 years. Rather, it is "technology which has cheapened the cost of products and made more things available to more people".

23. Page (1983, p. 215) observes that "the patchwork of regressive tax loopholes, from depletion allowances to consumer interest deductions to tax shelters for Park Avenue 'farmers' hardly makes sense as a rational economic design, but it does correspond to lobbying efforts by the wealthy and the well organized". In Canada, "tax expenditures", a form of "giving by not taking", also have a very strong bias in favour of the highest income category, i.e., a taxable income over $50,000. See Howard and Stanbury (1984) and Appendix V. Page (1983, p. 216) also argues that the small size and shape of peculiar programs designed to redistribute to the poor reflect the lack of organization by the poor themselves. The counter efforts of conservative groups, and the ability of those who provide services to the poor to divert government dollars to their own pockets.

Chapter 4

GOVERNMENT ACTION TO CREATE RIGHTS

> The language of rights now dominates political debate in the United States. Does Government respect the moral and political rights of its citizens...The concept of rights, and particularly the concept of rights again the Government, has its most natural use when a political society is divided, and appeals to co-operation or a common goal are pointless. (Dworkin, 1977, p. 184)

1.0 INTRODUCTION

Governments use their powers not only to try to improve the efficiency with which resources are allocated and to alter the distribution of income but they also define, enforce, and effectively create rights for individuals. Some philosophers argue that each man in a state of nature possess certain inalienable rights by reason of his existence, and that all governments can do is to acknowledge those rights. In practical terms, however, one's rights are what governments define them to be and what they are willing to enforce when called upon to do so by the individuals who are said to possess those rights.

Initially, we can use a dictionary definition of a right as "a just and proper claim or title to any thing or that which may be claimed on just, moral, legal, or customary grounds". Despite elaborate and complex rationales, fundamentally, rights are norms. They embody pure value judgments, although if these judgments are widely-held the definition of particular rights may take on the flavour of axiomatic truth.

A critical characteristic of rights is that they are non-market entities. They are or become part of the holdings (or "assets") of individuals. Usually rights are distributed equally among all citizens or equally among the members of certain groups in society. They inhere in the individual and either by

definition or by design are not tradeable. There is no market in which rights may be exchanged for other rights or for other valuable consideration. For example, it is illegal to sell one's vote and a person cannot exchange his right to vote for some other right or conventional asset. Similarly, one cannot contract to sell oneself into slavery or even into servitude. Hence, society is placing limits on the right of freedom to contract.

It might even be argued that while rights are created (and perhaps extinguished) in the political process, once they are created they are "taken out" of the bargaining arenas of that process just as they appear to be removed from economic markets. Disputes about rights are often resolved within the judicial system in which objectivity and impartiality are the prevailing norms. Some conflicts among rights, of course, cannot be authoritatively resolved by the judicial process, hence the matter moves inevitably back to the political arena.

Social reformers have sought to go beyond the redistribution of income or wealth by the creation of rights to a whole variety of both political and economic goods. Stanbury and Lermer (1983, p. 396) point out that "when an income claim is transformed rhetorically into a 'right', it becomes harder to resist in a democracy which sees itself as economically as well as politically egalitarian". The demand for occupational health and safety regulation can be couched in terms of workers' "right to life", or at least their right not to die from exposure to certain occupational hazards. A situation characterized by a market failure -- imperfect information -- is transformed by the creation of a right into an absolute prohibition upon some working conditions. For some the purpose of creating the right to safety is precisely to prevent certain types of exchanges: higher wages for more hazardous working conditions.[1] Okun (1975, p. 20) argues that minimum wage legislation and work safety requirements "can be

viewed most fruitfully as further example of prohibition on exchanges born of desperation...That desperation may result from ignorance, immobility, or genuine lack of alternatives, but it should be kept out of the marketplace."

2.0 THE CONCEPT OF RIGHTS

2.1 Individual Rights and Collective Goals

What are rights? Dworkin (1977, p. xi) argues that "individual rights are political trumps held by individuals". He continues, "individuals have rights when, for some reason, a collective goal is not a sufficient justification for denying them what they wish, as individuals, to have or to do, or not a sufficient justification for imposing some loss or injury upon them". This approach to the concept of rights does not suppose they have some special metaphysical character. I shall refer to such rights as "fundamental rights".

The most fundamental right is the right of equality -- the right of equal concern and respect. Dworkin (1977, Ch. 12) argues that the right to the liberties in the United States Constitution, for example, are derivative, not from a more abstract general right to liberty as such, but from the right to equality itself. The first sentence of the U.S. Declaration of Independence refers as a fact to "the separate and equal station to which the Laws of Nature and of Nature's God entitle [men]".

Legal rights, on the other hand, are a distinct species of a political right, that is, an institutional right to the decision of a court in its adjudicative function (Dworkin, 1977, p. xii). The concept of a legal obligation is based on a valid legal rule that requires an individual to do or to forbear from doing something.

To get at the core of the concept of the fundamental rights of each individual it is necessary to distinguish them from collective goals. Dworkin (1977, p. 91) holds that

> A [collective] goal is a nonindividuated political aim, that is, a state of affairs whose specification does not in this way call for any particular opportunity or resource or liberty for particular individuals...Collective goals encourage trade-offs of benefits and burdens within a community in order to produce some overall benefit for the community as a whole.

In contrast, a fundamental right is an "individuated political aim". Dworkin (1977, p. 91) continues,

> An individual has a right to some opportunity, resource or liberty if it counts in favor of a political decision that the decision is likely to advance or protect the state of affairs in which he enjoys the right, even when no other political aim is served and some other political aim is disserved thereby, and counts against that decision that it will retard or endanger that state of affairs, even when some other political aim is thereby served.

This statement is not easy to understand, but it appears to embody the idea that a fundamental right is a type of absolute. The existence of such rights can be identified if political decisions are taken whose only purpose is to advance and protect that right. Even stronger evidence of the existence of a right is when political decisions are taken to advance and protect that right even though other political aims are sacrificed in the process.

2.2 Essential Characteristics of Fundamental Rights

Rights are individuated, that is they relate to each and every person as an individual, not as a member of a group except society as a whole. Rights-based political theories place the individual at the centre of the analysis, and take his decision or conduct (or welfare) as being of fundamental importance. They are concerned with independence rather than conformity of individual action (Dworkin, 1977, p. 172).

Fundamental rights are frequently highly abstract, e.g., the right to free speech. As such they symbolize and embody "a general political aim the statement of which does not indicate how that general aim is to be weighed or compromised in particular circumstances against other political aims" (Dworkin, 1977, p. 93). In contrast, concrete rights are political aims that are more

precisely defined so as to express more definitely the weight they have against other political aims on particular occasions.

The fundamental rights of individuals, by definition, cannot be outweighed by social goals or collective goals. In other words, rights cannot be compromised by public policy actions in the name of the general good. The utilitarian calculus implicit in the justification of many public policies does not apply, namely that policies should be adopted if they serve the greatest good of the greatest number. This very strong concept of fundamental rights of a citizen against his government (such as free speech) holds that it would be wrong for the government to abrogate or derogate that right on the grounds that the general welfare would be increased by so doing. The government may be justified in overiding such rights when it is necessary to protect the rights of others or to prevent a major catastrophe. The fact that a government passes a law to seek to extinguish such a right does not make it morally correct to do so. In fact, such legislation is a wrong; the fundamental right remains (Dworkin, 1977, pp. 190-192).

The rights of individuals vis-a-vis the State are both positive and negative. In Dworkin's (1977, p. 193) words, "Citizens have personal rights to the State's protection as well as personal rights to be free from the State's interference..." The right to a trial by a jury of one's peers falls into the former category, while Article III of the amendments to the U.S. Constitution illustrates the latter. It provides that "no soldier shall, in time of peace, be quartered in any house, without the consent of the Owner, nor in time of war, but in a manner to be prescribed by law". Similarly, Article IV provides that "the right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated...". The larger and more "efficient" government becomes, the greater the need for the

individual to have fundamental rights, enforced by an independent judiciary, to be protected from the actions of the state.

The rights of individuals, particularly the most abstract, will inevitably come into conflict. The frequency and subtlety of such conflicts will also increase as the number of such rights increases. Therefore, when individual rights conflict, it is the task of the government to discriminate among competing claims. Government may limit one fundamental right if it believes another fundamental right is more important. However, Dworkin (1977, p. 194) emphasizes that, "the existence of rights against the Government would be jeopardized if the Government were able to defeat such a right by appealing to the right of a democratic majority to work its will". Dworkin continues, "In order to save them [fundamental rights], we must recognize as competing rights only the rights of other members of society as individuals". In other words, in this concept of fundamental rights it is acceptable to trade off one fundamental right for another where they come into conflict. One recalls the dictum of Mr. Justice Holmes that a man's right to free speech does not extend to shouting "fire" in a crowded theatre when there is no fire. In this context, the right to safety and security comes into conflict with the right to free speech. However, in this concept of fundamental rights it is not acceptable to trade off the fundamental rights of one or some individuals in order to achieve some collective goal -- even if it is deemed that the welfare of society would thereby be increased.

The basis of this concept of fundamental rights possessed by each individual does not lie in the idea that they are inherent in each human being in a state of nature ("natural rights"), or that they are given by the Deity. Rather the concept is supported on two possible bases according to Dworkin (1977, pp. 198-99). First, that we accept the vague but powerful idea of human

dignity which "supposes that there are ways of treating a man that are inconsistent with recognizing him as a full member of the human community, and holds that such treatment is profoundly unjust". The second basis is the idea of political equality. "This supposes that the weaker members of a political community are entitled to the same concern and respect of their government as the more powerful have secured for themselves, so that if some men have freedom of decision whatever the effect on the general good, then all men must have the same freedom." Hence, rights are necessary to protect the dignity of human beings or to protect their standing as equally entitled to concern and respect.

There are many types of rights that can be distinguished from the fundamental or political rights of individuals discussed above. For example, Dworkin (1977, p. 93) distinguishes between background rights -- those that provide a justification for political decisions by society in the abstract -- and institutional rights -- those that provide a justification for a decision by some particular and specified political institution. The fundamental rights of individuals are what he also calls background rights.

Moreover, we can distinguish between rights individuals have against the state (which as we have seen, may be positive or negative) and those they have against fellow citizens. The right to have the terms of one's contracts adjudicated by the courts and enforced by agents of the state is a right of one individual vis-a-vis another. The right to privacy deals with both types of rights. Dworkin (1977, p. 94) argues that a right to a minimum standard of housing, for example, if it is accepted, is a right against the state, not other individuals. However, it is obvious that the means to satisfy one individual's right to housing will be obtained from other individuals.

We can distinguish universal rights, e.g., the fundamental rights as discussed above, from special rights that apply to some individuals but not to

others. For example, in Section 35 of the Canadian Constitution Act, 1982 "the existing aboriginal and treaty rights of the aboriginal peoples of Canada are hereby recognized and acknowledged". Aboriginal peoples, we are told in the same section, "includes the Indian, Inuit and Metis people of Canada". We can look forward to plenty of litigation to determine which individuals fall within these three categories, particularly if these rights -- now ill defined -- turn out to be valuable.

3.0 ORIGINS OF RIGHTS

Rights may originate in a variety of ways. First, rights may be granted or conferred by God or other Deity on man in order to improve his life on earth. In a world of some unbelievers, the details of how such rights are implemented in a practical fashion present interesting problems. Second, rights may be conceived of as inherent in the nature of man. They are, in effect, part of the definition of what it is to be a human being as opposed to other living things.[2] This is the concept of "natural rights". While men may choose to limit the full extent of their individual rights to life in society -- in order to achieve the benefits of cooperation -- the state does not confer or create such rights although it may play an important role in defining legal terms and in administering them.

Dworkin (1977, p. xi) notes that "legal positivism rejects the idea that legal rights can pre-exist any form of legislation; it rejects the idea, that is, that individuals or groups can have rights in adjudication other than the rights explicitly provided in the collection of explicit rules that compose the whole of a community's law". He continues, "economic utilitarianism rejects the idea that political rights can pre-exist legal rights; that is, that citizens can justifiably protest a legislative decision on any ground except that the decision does not in fact serve the general welfare".

This concept of natural rights inherent in the individual is embedded in the American Declaration of Independence of 1776: "We hold these truths to be self-evident, that all men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are Life, Liberty and the pursuit of Happiness -- that to secure these, Governments are instituted among Men, deriving their just powers from the consent of the governed".[3]

Third, rights may be created by some form of collective agreement, usually through the means of the institution of government. Again we should be clear that the state is not creating rights in this case, although it is the instrument through which such rights are defined, and enforced. In effect, the state is the means to ratify and enforce the agreement among individuals. The power of the state (coercion) is also used to "confer" these new rights upon the minority that dissented. For example, some psychologists argue that an important cause of mental illness is the extent of individual freedom in a liberal democracy. Where do such rights come from? Probably they stem from widely-held ethical norms and they may be matters of pure belief. To paraphrase Lord Devlin, if the reasonable man believes that certain rights exist and should be protected by government or that they ought to exist, no matter whether the belief is right or wrong -- so long as the belief is honest and dispassionate that no right-minded member of society could think otherwise -- then such rights ought to be created. Our concept of rights, like that of morality, stem from a blend of custom and conviction, of reason and feeling, of experience and prejudice.

Fourth, the state, can create rights of its own volition. In this case it does not merely define and enforce rights created by agreement, inherent in individuals or given by God, rather the state is acting as an "independent" agent and not as an agent for the collective will of individuals. Perhaps the most obvious example is a totalitarian regime. In August 1984 Yelena Bonner,

the wife of Soviet physicist Andrei Sakharov, was convicted of "defaming the Soviet state", which suggests the state can have rights like those of a natural person. It should be emphasized that the rights created by such a state may well conflict with natural, God-given rights, and with rights established by agreement among individuals.

Fifth, we should recognize that rights can be created by a series of private actions -- disputes really -- in which judicial decisions create precedents. In other words, rights are created, altered and even extinguished by the growth of the common law. Subsequently, the legislature may codify the rights established in the common law by creating statute law or it may alter or even extinguish such rights. This illustrates the doctrine of parliamentary supremacy accepted in common law countries such as England and Canada.

4.0 THE GROWTH OF RIGHTS

As there are many kinds of rights, it is useful to distinguish several types. We begin with the rights outlined in the new Canadian constitution which are grouped into "fundamental freedoms", "democratic rights", "mobility rights", "legal rights", "equality rights", "language rights" and "aboriginal rights".

4.1 Rights in the Canadian Constitution

The new Canadian Charter of Rights and Freedoms embodied in the Constitution Act, 1982 declares that "everyone has the following fundamental freedoms":[4]

(a) freedom of conscience and religion;
(b) freedom of thought, belief, opinion and expression, including freedom of the press and other media of communication;
(c) freedom of peaceful assembly;
(d) freedom of association.

In addition, the following "democratic rights" are specified:

- each citizen has a right to vote in federal and provincial elections and to run for election;
- elections must be held at least every five years; and
- Parliament and each provincial legislature must sit at least once every 12 months.

Section 6 of the Constitution Act, 1982 specifies certain "mobility rights" which might also be construed as a form of "economic rights". These include:

- the right of every citizen to enter, remain in and leave Canada;
- the right of every permanent resident to move to and take up residence in any province and to "pursue the gaining of a livelihood in any province".

Sections 7 - 14 of the Charter set out a number of "legal rights" such as:

- the right to "life, liberty and security of the person and the right not to be deprived thereof except in accordance with the principles of fundamental justice";
- the right to be secure against unreasonable search or seizure;
- the right not to be arbitrarily detained or imprisoned;
- certain rights on arrest or detention and on being charged wtih an office (e.g., "to be tried within a reasonable time" and "to be presumed innocent until proven guilty...");
- the right not to be subjected to any cruel or unusual treatment or punishment; and
- protection against self-incrimination.

Section 15 the Constitution Act, 1982 defines certain "equality rights". They consist of equality before the law and the right to equal protection and equal benefit of the law without discrimination based on race, national or ethnic origin, colour, religion, sex, age, mental or physical disability. These rights did not go into effect until 1985, three years after the the Constitution came into force.

Section 17 sets out the "language rights" embodied in the constitution. English and French are declared to be the official languages in Canada (and in New Brunswick) and they have "equality of status and equal rights and privileges as to their use in all institutions of the Parliament and government of Canada". Hence the individual's right to deal with the many agencies of the

federal government in either or both official languages which is spelled out in section 20. This right applies to the head or central office and elsewhere where "there is a significant demand" for service in the language of the citizen.

The Constitution Act, 1982 also enshrines certain "minority language educational rights" in section 23. These rights, however, are on a where-numbers-warrant-basis. Aboriginal rights are said to be protected by section 25, although the exact nature of those rights is not known. More unusually, the rights and freedoms in the Charter are guaranteed not to be construed so as to abrogate or derogate from any rights aboriginal people may acquire by way of land claims settlement in the future.

Section 35 of the Constitution Act, 1982, which is not part of the Charter of Rights and Freedoms, as we have noted, "recognizes and affirms" the existing aboriginal and treaty rights of the Indian, Inuit and Metis peoples of Canada.

In the same vein, the Charter in S. 29 declares that it does not abrogate or derogate from any rights guaranteed by the Constitution in respect of "denominational, separate or dissentient schools".

This is an impressive list of rights -- all the more impressive because they are spelled out in the Constitution. Because they are entrenched in the Constitution they are protected from an ephemeral parliamentary majority which can change an ordinary statute "on a whim". The real meaning of these rights is more problematic for several reasons. First, they are not unconditional. Indeed, Section 1 of the Charter of Rights and Freedoms begins with a condition. The rights and freedoms are "subject only to such reasonable limits prescribed by law as can be demonstrably justified in a free and democratic society". The Supreme Court of Canada has said that, in determining whether legislation limiting a fundamental freedom in sections 2 or 7 of the Charter, a court should consider and assess the following factors:

(a) the object or rational basis of the limitation;

(b) the extent of the limitation which is to be balanced against its rationality; and

(c) the laws and practices in other jurisdictions generally regarded as free and democratic.

In general, the Supreme Court was of the view that in considering the reasonableness of the limitation, a court should exercise a high degree of caution before substituting its opinion for that of the legislature. This suggests that if the Supreme Court of Canada tends to defer to Parliament and the provincial legislatures, the latter may be able, in other statutes, to impose substantial restrictions on the rights set out in the Constitution.

Second, the operational meaning of general rights in specific situations depends upon how the courts, particularly the Supreme Court of Canada, will interpret the words of the Constitution. The new Constitution has been described as a full employment act for lawyers. The metes and bounds of the long list of rights codified in 1982 will take years to determine as the courts of appeal struggle with their application in specific situations. It is possible that what parliament has given the courts will take away. It is also possible that the courts will offer authoritative interpretations of parliament's words beyond what the legislators intended would be the actual effect of the words they enacted. Hence, amendments may be necessary for Parliament to achieve its objectives.

Third, even if the new rights are interpreted in an expansive fashion their impact may be limited by the lack of public and private resources to give them meaning in at least some situations. Indeed, in some cases the legal interpretation of a right may be influenced by the court's perception of the anticipated resource consequences of an expansive interpretation. A possible example is the issue of equal pay for work of equal value as advanced by some groups who feel they have been systematically discriminated against.

4.2 Other Rights Including Emerging Rights

Rights, or what people claim to be rights, exist in statutes other than the constitution. Moreover, there is considerable evidence of the demand for new rights or of the use of the rhetoric of rights to justify new legislation. Consider the following examples:

(a) Non-discrimination rights are being extended to include sexual orientation, mental or physical disability, and age as well as sex, creed, colour, religion, or ethnic origin.

(b) The federal Access to Information Act of June 1982 created new rights concerning access to information held by the federal government, although the exact nature of these rights is still being determined.

(c) Do the citizens of "have not" provinces in Canada have a right to equalization payments? There are commitments in the 1982 Constitution by the federal government to the principle of making equalization payments to ensure that provincial governments have sufficient revenues to provide "reasonably comparable levels of public services at reasonably comparable levels of taxation". Commitments are also made in Section 36 by the federal and provincial governments to promote "equal opportunities for the well-being of Canadians"; further..."economic development to reduce disparities in opportunities"; and to provide "essential public services of reasonable quality to all Canadians".

(d) The 1975 Quebec Charter of Human Rights and Freedoms specifies a number of "economic and social rights" including the following:

   (i) Every child has a right "to the protection, security and attention that must be provided to him by his family or persons acting in their stead". Can a child sue for specific performance and/or damages?

   (ii) Everyone has the right to "free public education"..."to the extent and according to the standards provided for by law". Does this mean that

an individual is entitled to financial support from government so that he may avail himself of this right?

(iii) Every person and his family has a right "to measures of financial assistance and to social measures provided for by law" to ensure "an acceptable standard of living". Is an acceptable standard simply that which is provided in the relevant provincial regulations?

(iv) "Every aged person and every infirm, mentally defective or mentally ill person has a right to protection against any form of exploitation." What is "exploitation"? Marxist writers construe this term very broadly -- so as to include most employment situations.

(v) "Persons belonging to ethnic minorities have a right to maintain and develop their own cultural interests with other members of their group." Are such minorities entitled to public funds to develop those interests?

Other chapters of the Quebec charter specify a right to privacy, and even that "every human being whose life is in peril has a right to assistance".

(e) Consumer protection legislation has been justified as being based on each consumer's right to be informed about the products and services they purchase, their right not to be defrauded or misled, and related rights. These rights were first advanced by President Kennedy in the early 1960s.

(f) Health and safety regulation has been justified on the basis of each individual's right to use safe products and to work in a safe environment.

(g) The strongest proponents and defenders of government financed medical care invoke the concept of each individual's right to medical care as a basic human need. More recently this right has been redefined and extended as a right to universal, free medical care. It is argued that the right must be universal and free so as not to conflict with the emerging right of "non-stigmatization", i.e., the right to obtain a wide variety of

publicly-financed services without providing any evidence of one's ability to pay for them (except, of course, as a taxpayer).

The list could go on and on.

5.0 THE POLITICAL ECONOMY OF RIGHTS

Rights can be created by government as a means to an end such as to effect a change in the distribution of income, wealth or consumption opportunities. In other words, instead of using such familiar governing instruments such as taxes, transfers or regulation to alter distributional outcomes, governments may create rights. This is more likely to occur when "economic rights" are created, e.g., the right to affordable housing or the right to free medical care.

Creating rights has both distributional and allocative consequences. Indeed, it might be argued that the proponents of the creation (or recognition) of new rights seek them precisely because of their distributional consequences and the potential ability to legally enforce them. Because rights create claims, "economic rights" may become the means by which the "have nots" acquire the legal means to extract part of the holdings of the "haves". They now can require the state to use its coercive powers to take from others the means to satisfy their legal claims stemming from their rights.

Rights can also be ends in themelves as the discussion of fundamental rights above suggests. The definition and enforcement of such rights can be seen as inherent in what all persons (or at least the overwhelming majority) see as the nature of the the good society itself. In other words, human welfare depends on more than material welfare regardless of how it is distributed. Rights are important ends in themselves in determining the welfare of individuals. They help to define what it is to be a member of society.

There appear to be some practical considerations why reformers or merely self-interested individuals -- and it is sometimes hard to separate the two --

seek to use the power of the state to create (or acknowledge) rights as opposed to other kinds of action. How else can we explain both creation of many new rights (of some type) in modern times and the clamour to create many more? The answers may lie in certain characteristics of rights themselves.

The concept of a "right" has considerable appeal as a symbol. The word itself is highly evocative and its frequent impassioned use in political discourse is almost certainly a result of that fact. For example, the struggle by the Haida Indians to assert their land claims with respect to Lyell Island has been described as "first and foremost ... a human rights issue" by a representative of the Anglican Church of Canada.[5] A spokesman for the United Church has said that "the issue for us is justice for the native people". In other words, which might be narrowly construed as a claim regarding a pecuniary interest in land is being redefined as a "human rights issue" or as a matter of "justice". This characterization of the issue raises its emotional temperature and it seeks to alter the nature of the issue. Property rights are to be transformed into human rights precisely because the former lack the wide appeal of the latter. This is because of the false dichotomy: property has no rights; only natural persons can have rights -- some of which may concern the ownership of property and some of which may concern how they may be treated by other individuals and by the state.

In general, rights are equally distributed (thereby satisfying the insatiable craving for egalitarianism); they are often believed to inhere in the individual as a person (and thereby legislation is merely recognition of a pre-existing situation in the name of justice); and for some, rights are inalienable -- they cannot be taken away or if one attempts to do, so a moral wrong is committed.

As we have described above, rights in their strongest form are expressed in unconditional terms. For example, what we have called fundamental rights is

explicitly unconditional with respect to the general welfare. Dworkin (1977, p. 269) states "If someone has a right to something then it is wrong for the government to deny it to him even though it would be in the general interest to do so". He calls this definition an anti-utilitarian concept of a right.

Even if we accept Dworkin's concept of fundamental rights (and many do not), it does not follow that we should apply this strong definition outside the area of political rights (e.g., free speech, universal suffrage, etc.) or of human rights (e.g., non-discrimination on the basis of sex, religion, colour etc.). Are we creating a number of "economic rights" and in doing so have not anticipated the consequences? What appears to be happening is an effort by some to convert individual wants (or "needs") into an enforceable right to certain income or consumption claims against the state, i.e., all other citizens. "Basic human needs" are to become rights and the power of the state is to be used to effect the necessary taxes and transfers to see that these new rights to "distributive justice" are enforced.

The creation of certain types of rights by government appears to defy the first law of economics: "There is no free lunch". Except for exhortation, political pressure, and the time of the legislature, rights can be created rather inexpensively, or so it would seem. In the political process in which they are created their advocates concentrate ruthlessly on matters of principle -- because rights are the embodiment of great principles -- the very ideas of conflicts, trade-offs and opportunity costs are studiously avoided.

One does not have to be a cynic to argue that reformers advocating the creation of a right use the rhetoric of rights in order to "elevate" the discussion to one of abstract principles precisely to alter the likely decision by reason of the absence of information on opportunity costs broadly construed. This is part of what one might call the "wedge and lever" technique. The thin edge of the wedge is introduced by focusing the public debate on principles or

even on alleged, pre-existing rights and away from opportunity costs, trade-offs and the practical implications of creating such rights. Indeed, the argument will be made that it is immoral to think in terms of trade-offs and particularly in such pedestrian terms as material goods and services foregone. Rights, it will be argued, come before material well being or they lie above materiality. They are, in effect, on a higher moral plane.

The "lever" comes into use once the right is enshrined in law in as general terms as possible. The legal definition of the right becomes the lever by which to command public and private resources to alter public or private behaviour. After all, what good is a right that cannot be enforced for those that possess it? If something is truly a right, then cost is no object or at least should not be. If each individual has a right -- an absolute right -- to free medical care, then the 87-year old indigent who may have only a few months to live has a claim against his fellow citizens (via government) to require the expenditure of hundred of thousands of dollars to provide him with the best care extant. To do less will be to abrogate that right to free medical care. The fact that the same bundle of resources has an opportunity cost perhaps even in terms of other lives that could have been saved or prolonged is ignored. Indeed, it is often the advocates of rights seek to deny the case that the need to make trade-offs or to appreciate that rights come into conflict. For example, a supporter of the Haida Indian land claims in British Columbia in 1985 is quoted as saying: "We really feel strongly that the Haida have title to that land. ...We recognize that [the jobs of loggers and sawmill workers] are a concern, but there have to be other ways of finding solutions than pitting one sector against another, when the real problem is a political one."[6]

People may seek to create rights in order to remove certain things (exchange relationships) from the market. While rights can be constrained or limited, usually because they come into conflict with other rights, they cannot

be traded among individuals. Indeed, often such trades are specifically prohibited. One cannot give up one's right to equal treatment before the law (in some sense) for some pecuniary or non-pecuniary benefit.

Trading is prevented, presumably, because most rights are to inhere in the individual. They are personal endowments that should only be exercised by those on whom they were endowed. Rights require "specific performance", although in some cases we seek to compensate for the loss of certain rights (e.g., false imprisonment) by monetary compensation.

While certain types of basic political and human rights probably only make sense as personal, non-tradable endowments, as we enlarge the domain of rights the prohibition on trading becomes less logical and more costly to society in terms of foregone oportunities for mutual gains from trade.[7] The point is that rights often impose restrictions on the gains from trade. Individuals can be made better off if such trades are allowed. Why are they prevented? Is it because A's welfare depends strongly on what B is not allowed to do even though B's consumption has nothing directly to do with A? As Evans points out,

> the Moral Majority in the U.S. is a dramatic example of a group with very complex utility function interactions, who allege that their welfare is affected by all sorts of activities by others which have no discernable direct impact on them, and who argue that the state...should respond to their preferences with regulations to control such behaviour (Evans, 1982, p. 465).

This desire to take certain things out of the market may reflect a number of motivations. It may be based on a belief that creating a right is the best way to solve the genuine market failure. It may be based on a moral principle that it is wrong, for example, to allow men to accept a high wage for known risky working conditions. Or it may be based on paternalism -- i.e., the reformer claims to know what is best for those presently engaged in the transaction. Finally, the basis of creating rights may be in the narrow self-interest of the reformer, namely, that he will be able to exercise the discretion involved in administering and enforcing this newly created right.

The creation of rights takes place in political markets. Enforcement of rights relies on both public and private resources and the authoritative decision making of the impartial judiciary.[8] Where a reformer can transform individuals' desires (wants) into widely recognized "needs" and then into a "right" he has greatly increased the leverage individuals have in fulfilling their desires. They can now call upon the coercive powers of the state to alter the behaviour of other individuals so as to obtain the benefits of their right.

There is another side to it as well. Rights enshrined in law are less vulnerable to the vagaries of politics than simple tax, expenditure, or even "tax expenditure" policies. What politicians give in Program X today they can easily change next year. Rights are harder to change since principles are at stake, not mere instrumentalities. If rights can be enshrined in a constitution, then they are much more difficult to change or remove. If a group is sufficiently politically effective at one moment to persuade a government to create a right, they can, in a limited sense, take the issue "out of politics" and then call upon the judiciary to enforce this right. What was subject to annual bargaining, by its transformation into a right, becomes much less vulnerable to short run political "wheeling and dealing". Even if it is not in the constitution, the longer an ostensible right is acknowledged as a right, the more difficult it is to remove it. In effect, long-established custom creates a type of right.

Rights created today limit future political choices. Former Prime Minister Trudeau was able to transform an idea (bilingualism) into a government policy and finally into a constitutionally-protected right. Regardless of their feelings about the right to bilingualism in dealing with and within the federal government, future prime ministers are going to find it all but impossible to diminish this right. Rights are a sort of "gift that keeps on giving". Their true impact is known only in the fullness of time as the judiciary tries to deal with the abstract in specific situations.

The effective implementation of rights requires a high degree of central coordination and centralized allocation of resources. Indeed, rights can only be created on a centralized basis, by government. The genius of competitive markets, however, lies in the fact that they require no such centralization. Rather, markets are able to function efficiently on a decentralized basis by means of price signals. When allocation is artificially centralized, signalling by individuals becomes problematical, i.e., it becomes difficult for individuals to express their preferences. Market trades are ruled out, so the political system is used to some extent to "signal" the public's preferences in respect to rights. Individuals become the primary complaint generators, but zealous public officials may be employed to see if rights are being enforced: one thinks of the "language police" in Quebec who enforce Bill 101.

Because substitutability is ruled out between rights and money (or material things), marginal adjustments, as people seek to "optimize on rights", appear to take two forms. First, actions are taken by government and the courts to limit the domain of one right when it comes into conflict with other fundamental rights. Second, adjustments may be made in the amount of real resources devoted by the state to actually conferring the benefits of rights upon individuals. We know that while society refuses to overtly acknowledge these types of competing claims, individuals and groups within major institutions are making decisions every day that give priority to some at the expense of others.[9] A right to a socially acceptable minimum standard of living, for example, may be operationally determined by the budget which in turn may be a function of the public's tolerance for additional taxation or inflation. But if this right was constitutionally protected, the process of adjustment may be constrained.

Where rights are defined as zero--one propositions, marginal adjustment is impossible and in political terms, compromises are ruled out. The right to life, if it is defined as an absolute, is not the right to life if abortions are

permitted for any reason. On the other hand, it can be argued that the right to own and control one's body is hollow if it does not include the right to an abortion by the woman's own choice. Political demands formulated as rights will almost always lead to sharper conflict than when they are formulated only as normative positions that should be embodied in public policy and programs.

Why do we distinguish the creation of rights fom government actions to redistribute income or improve the efficiency of resource allocation? In general, government actions to redistribute income or improve efficiency are embodied in particular programs. These programs make use of one or more of the governing instruments such as taxes, direct expenditures (including both transfers and exhaustive expenditures), regulation, Crown corporations, tax expenditures, mixed enterprises, loans and guarantees, and suasion (see Trebilcock et al,. 1982). For example, we note tht cash transfers are made to the unemployed in order to redistribute income from those with work to those without it. Second, we note the use of regulation to reduce pollution emissions from automobiles and various industrial processes to reduce harmful externalities and thereby improve allocative efficiency.

In general terms, each program (using the term broadly) has to compete with every other program for resources, both financial and political. Trade-offs are made among programs and within programs. There is a "market" for government programs even if it operates slowly, roughly and in mysterious ways.[10] In the case of some transfer programs there are legal criteria for eligibility. Hence individuals can take legal action to enforce their claims to be recipients. But the beneficiaries or potential beneficiaries of most forms of government action have no basis of legally obtaining "their share" of government largesse.[11] Nor have they much opportunity to be free of the negative consequences of government action such as taxes or regulation. These disputes are resolved in the political arena where promises of new policies or changes in existing ones are exchanged for promises of political support (see Stanbury and Thain, 1985).

Rights, however, are different from government programs (broadly defined) in several important ways. First, rights created by government often give their possessor the power to use the coercive instruments of the state to enforce the claims they represent either on other individuals or on the state itself. If all adults have the right to vote in elections, then an individual who is prevented from voting by force by other individuals may require the state to come to his aid and restrain those who would prevent him from voting. If everyone has a right to a minimum standard of living and that right is enshrined in statute, then those who believe that they fall below the standard could use the courts to enforce their right. Presumably a court could order a government department to make payments to an individual if it finds they are below the minimum.

Second, if a right is enshrined in the constitution, it gains a far greater degree of protection than if it is merely embodied in an ordinary statute. It becomes much harder to change -- as the history of Canada makes clear. Indeed, constitutionally protected rights can take on the aura of "untouchability". This is not to say that the courts' interpretation of a constitutionally protected (guaranteed) right does not change over time. But such change tends to be slow and incremental in character.

But even rights in ordinary statutes tend to be harder to alter than government actions in the form of programs. Expenditure programs face the annual budget cycle; many Crown corporations are highly dependent on the sale of their output and face competition; regulatory decisions can be appealed to the cabinet and/or the courts; even tax expenditures face periodic scrutiny.

Third, rights tend to be absolutes while efforts to alter the distribution of income or improve efficiency are clearly matters of degree. It is easier to make adjustments at the margin on these matters than it is with respect to rights. If everyone has a right to affordable housing, and affordability is

defined as a household paying not more than X% of its income for rent, then those who are paying more than X% have a specific enforceable claim to sufficient financial assistance to meet the criterion. On the other hand, a transfer program to "help the disadvantaged meet their housing needs" can be funded at any level deemed appropriate by the legislature from time to time in light of competing priorities.

The important point is this -- the more rights we create, the more indivisibilities we create. The more indivisibilities the harder it is to make small adjustments and to make trade-offs. The creation of a host of legally enforceable economic rights makes a society more rigid and less able to adapt to changes over which it has little control. In seeking to protect individuals and to "guarantee" them certain levels of consumption we may be constraining the society's capacity to generate the level of income necessary to give everyone the benefit of what they believe to be their rights.

Notes to Chapter 4

1. How should we handle the problem of worker health and safety. It is an area where real market failures exist -- and largely in the form of imperfect knowledge (or uncertainty) and costly and asymmetric information. In many instances government action can improve the allocation of resources by providing costly information to employers and employees. However, if the issue is seen in terms of an individual's right to work in a "safe" environment, provision of information is held to be insufficient. Certain working conditions are to be absolutely prohibited even if all the actors are perfectly well-informed of the risks and compensated for them. The right to safety prevents a voluntary and well-informed exchange in work places that fail to meet conditions established in legislation. Certain gains from trade are prohibited. Precisely because of the reformer's distaste for markets, even in the absence of information failures, the creation of a right removes some transactions from the market in the name of creating a benefit for those involved.

2. Recently, some individuals have argued strongly that animals have rights; hence certain types of experiments should not be conducted upon them by human beings.

3. It is important to appreciate that the Declaration, not surprisingly given its momentous connotations, advanced the right to overthrow a despotic government: "whenever any form of Government becomes destructive of these ends [life, liberty etc] it is the Right of the People to alter or to abolish it, and to institute new Government...". There is no similar provision in the Canadian Charter of Rights and Freedoms.

4. In Canada, in contrast to the United States, the doctrine of parliamentary supremacy prevails so that the rights defined in the new constitution (i.e., the Constitution Act, 1982) are prefaced in section 1 by the statement that the rights and freedoms set out in it are "subject only to such reasonable limits prescribed by law as can be demonstrably justified in a free and democratic society". In other words individuals' rights are hedged at the outset. The Canadian constitution begins with a qualification. The contrast with the American Constitution could hardly be greater. It begins with a ringing declaration of the rights of individuals and then goes about protecting those rights from possible threats by the democratically elected legislature which may reflect some transient majority's desire to tamper with or even try to remove such rights.

   The directness and simplicity of the rights set out in the amendments to the U.S. Constitution are obvious. Article I, for example, states that "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people to peaceably assemble, and to petition the Government for a redress of grievances." Similarly, Article XIV provides that "nor shall any State deprive any person of life, liberty, or property without due process of law."

5. Christie McLaren, "Churches back Haida in forestry feud", Globe and Mail, November 27, 1985, pp. A1, A2.

6. Ibid.

7. Suppose universal, free (or even heavily subsidized) day care achieves the status of a right that can only be exercized "in person" i.e., by parents. Then childless couples and single adults cannot benefit from this right. Yet they will be taxed to make the right a reality. In effect, a particular type of consumption good is being subsidized in kind only for those that fall into the category of parents. If the right was formulated as a minimum standard of living (consumption opportunities) adjusted for the number of children and the labour force participation of parents, both childless couples and those with children could exchange the direct cash transfers flowing from the right for the goods and services they value most. Some couples with children may buy day care services; others may decide to ask grandma to live in and help out. Some couples may decide to arrange for one to work while the other stays home with the children. In making the right consumption-specific, both individual and total welfare may be reduced.

8. It is interesting that the nation most celebrated for its popular democracy born of revolution should look to the courts to protect the rights of individuals on a continuing bases than to the legislature. The courts, however are to interpret the Constitution (although some accuse them of overtly creating new law) which is designed to be a "very stable platform" almost beyond the reach of the legislature. The Constitution can only be amended by a lengthy process which, in effect, requires a "super majority". One has only to recall the most recent effort to amend the Constitution: the equal rights amendment. An amendment to the U.S. Constitution requires the support of three-quarters of the state legislatures and a two-thirds vote of both the House and the Senate. Dworkin (1977, p. 133) explains this point as follows:

> The Constitution, and particularly the Bill of Rights, is designed to protect individual citizens and groups against certain decisions that a majority of citizens might want to make, even when that majority acts in what it takes to be the general or common interest...This interference with democratic practice requires a justification. The draftsmen of the Constitution assumed that these restraints could be justified by appeal to moral rights which individuals possess against the majority, and which the constitutional provisions, 'vague' and precise, might be said to recognize and protect.

9. While public institutions routinely handle implicit tradeoffs between various types of "statistical deaths" (e.g., expenditures on nuclear safety versus highway safety), they have real difficulty -- as we all do -- when faced with specific cases where the consequences are immediate. These have been called "tragic choices". Therefore, millions may be spent on a search and rescue mission to save a family in a small boat precisely because the prospects of death are not abstract or impersonal. The pictures of the family are on the television news. The search will go on until they are found or can almost certainly be presumed to be lost by the passage of time.

10. See the discussion of markets for regulatory programs in Trebilcock et al. (1978).

11. For example, there is no legal redress for the citizens of Toronto against either the federal or provincial government if funds are not provided for a new domed stadium that was the subject of much discussion in the summer of 1984.

REFERENCES/BIBLIOGRAPHY

Acton, H.B. (1971) The Morals of the Market (London: Longman).

Aitken, H.G.J. (1961) "Defensive Expansion: The State and Economic Growth in Canada," in W.T. Easterbrook and M.H. Watkins (eds.) Approaches to Canadian Economic History (Toronto: McClelland & Stewart).

Akerlof, George (1970) "The Market for 'Lemons': Quantitative Uncertainty and the Market Mechanism," Quarterly Journal of Economics, Vol 34(3), pp 488-500.

Alchian, A. and H. Demsetz (1972) "Production, Information Costs, and Economic Organization," American Economic Review, Vol. 62, pp. 777-795.

Alt, J.E. and K. Alec Chrystal (1983) Political Economics (Berkeley: University of California Press).

Anderson, T.L. and P.J. Hill (1980) The Birth of a Transfer Society (Stanford, Cal.: Hoover Institution Press).

Archibald, G.C. and David Donaldson (1976) "Non-Paternalism and the Basic Theorems of Welfare Economics", Canadian Journal of Economics, Vol 9(3), August, pp 492-507.

Arrow, K.J. (1974) "Limited Knowledge and Economic Analysis," American Economic Review, Vol 64, pp 1-10.

Arrow, K.J. (1970) "The Organization of Economic Activity: Issues Pertinent to the Choice of Market Versus Nonmarket Allocation" in R.H. Haveman and J. Margolis (eds.) Public Expenditures and Policy Analysis (Chicago: Markham Publishing), pp. 59-73.

Baggaley, Carman D. (1982) "Tariffs, Combines and Politics: The Beginning of Canadian Competition Policy, 1888-1900," (Paper prepared for The Institute for Research on Public Policy).

Bailey, E.E. and A.F. Friedlaender (1982) "Market Structures and Multi-product Industries," Journal of Economic Literature, Vol. 2(3), pp. 1024-48.

Baldwin, John R. (1975) The Regulatory Agency and the Public Corporation: The Canadian Air Transport Industry (Cambridge, Mass.: Ballinger).

Ball, Howard (1984) Controlling Regulatory Sprawl: Presidential Strategies from Nixon to Reagan (Westport, Conn.: Greenwood Press).

Bane, M.J. and Christopher Jencks (1973) "The Schools and Equal Opportunity" in Christopher Jencks in Perspective (Arlington: American Association of School Administrators), pp. 3-11.

Barry, Brian (1969) "The Public Interest" in W.E. Connolly (ed.) The Bias of Pluralism (Chicago: Atherton Press), pp 159-77.

Barry, Brian (1970) Sociologists, Economists and Democracy (London: Collier-Macmillan).

Barry, Brian (1973) The Liberal Theory of Justice (Oxford: Clarendon Press).

Barzel, Yoram (1977) "Some Fallacies in the Interpretation of Information Costs," Journal of Law and Economics, Vol 20, pp 291-307.

Bator, Francis M. (1957) "The Simple Analystics of Welfare Maximization," American Economic Review, Vol. 4, March, pp. 22-59.

Bator, Francis M. (1958) "The Anatomy of Market Failure," Quarterly Journal of Economics, Vol. 72(3), pp. 351-379.

Batson, H.E. (1933) "The Economic Concept of a Public Utility," Economica, No. 42, November, pp 457-472.

Baumol, W.J. (1969) Welfare Economics and the Theory of the State (Cambridge, Mass.: Harvard University Press).

Baumol, W.J., E. Bailey and R.D. Willig (1977) "Weak Invisible Hand Theorems on the Sustainability of the Multiproduct Natural Monopoly," American Economic Review, Vol 63(7) (June), pp 350-365.

Baysinger, Barry et al. (1980) "Mercantilism as a Rent-Seeking Society" in J.M. Buchanan et al. (eds.) Toward a Theory of a Rent-Seeking Society (College Station: Texas A&M University Press), pp 235-68.

Becker, Gary (1976) The Economic Approach to Human Behavior (Chicago: University of Chicago Press).

Becker, Gary (1983) "A Theory of Competition Among Pressure Groups for Political Influence", Quarterly Journal of Economics, Vol 98(3), pp 272-299.

Bedau, Hugo A. ed. (1971) Justice and Equality (Englewood Cliffs, N.J.: Prentice-Hall).

Bell, Daniel (1976) The Cultural Contradictions of Capitalism (New York: Basic Books).

Bell, Daniel (1972) "On Meritocracy and Equality," The Public Interest, No. 29, Fall, pp. 29-68.

Benham, Frederic C. (1931) "The Economic Significance of Public Utilities," Economica, No. 34, November, pp 426-436.

Benjamin, Roger (1980) The Limits of Politics (Chicago: University of Chicago Press).

Bennett, James T. and T.J. DiLorenzo (1983) Underground Government: The Off-Budget Sector (Washington: The Cato Institute).

Berk, Gerald P. (1981) "Approaches to the History of Regulation" in T.K. Mc Craw (ed.) *Regulation in Perspective* (Boston: Division of Research, Graduate School of Business Administration, Harvard University), pp. 187-204.

Berlin, Isaiah (1961) "Equality," in F.A. Olafson (ed.) *Justice and Social Policy* (Englewood Cliffs: Prentice Hall).

Bernstein, Marver (1955) *Regulation: Government by Independent Regulatory Commission* (Princeton, N.J.: Princeton University Press).

Berry, Jeffrey M. (1977) *Lobbying for the People: The Political Behavior of Public Interest Groups* (Princeton, N.J.: Princeton University Press).

Blackstone, W.T. (1967) "On the Meaning and Justification of the Equality Principle," *Ethics*, Vol 77, July, pp 239-53.

Bowe, Norman E. (1971) *Towards a New Theory of Distributive Justice* (Amherst, Mass: University of Massachusetts Press).

Boyer, Marcel and Ejan Mackaay (1980) "The Concept of Adequate Information: Market Failures and Their Correction," (Toronto: University of Toronto, Faculty of Law, Law and Economics Programme Working Paper WS II-120).

Braybrooke, David and C.E. Lindblom (1963) *A Strategy of Decision* (New York: The Free Press).

Breit, W. (1974) "Income Redistribution and Efficiency Norms" in H.M. Hochman and G.E. Peterson (eds.) *Redistribution Through Public Choice* (New York: Columbia University Press, in cooperation with the Urban Institute, Washington, D.C.), pp. 3-21.

Brennan, H.G. and J.M. Buchanan (1981) *The Power to Tax: Analytical Foundations of a Fiscal Constitution* (Cambridge: Cambridge University Press).

Breton, Albert (1976) *The Regulation of Private Economic Activity* (Montreal: C.D. Howe Research Institute).

Brewer, Garry D. (1981) "Where the Twain Meet: Reconciling Science and Politics in Analysis," *Policy Sciences*, June, pp 269-79.

Brewer, Garry D. and Peter de Leon (1983) *The Foundations of Policy Analysis* (Homewood, Illinois: The Dorsey Press).

Breyer, Stephen (1982) *Regulation and its Reform* (Cambridge, Mass.: Harvard University Press).

Briggs, B. Bruce ed. (1979) *The New Class* (New Brunswick, N.J.: Transaction Books).

Brown, Steven R. (1980) *Political Subjectivity* (New Haven: Yale University Press).

Browning, Edgar K. (1976) "How Much More Equality Can We Afford?" *The Public Interest*, No. 43, Spring pp 90-110.

Browning, Edgar K. (1980) "On the Welfare Cost of Transfers", in J. M. Buchanan et al. (eds.) Toward a Theory of a Rent-Seeking Society (College Station: Texas A&M University Press), pp 283-87)

Buchanan, James M. (1968) The Demand and Supply of Public Goods (Chicago: Rand McNally).

Buchanan, James and Robert Tollison (1972) Theory of Public Choice: Political Application of Economics (Ann Arbor: University of Michigan Press).

Buchanan, J.M., R.D. Tollison and G. Tullock, eds. (1980) Toward a Theory of a Rent-Seeking Society (College Station: Texas A&M University Press).

Buchanan, J.M. and R. Wagner (1977) Democracy in Deficit (New York: Academic Press).

Buchanan, J.M. and W.C. Stubblebine (1962) "Externality", Economica, Vol. 28, November, pp 371-84.

Burdick, C.K. (1911) "The Origin of the Peculiar Duties of Public Service Companies", Columbia Law Review, Vol 11(6), pp 514-531; Vol 11(7), pp 616-638, and Vol 11(8), pp 743-764.

Cairns, Robert D. (1980) Rationales for Regulation (Ottawa: Economic Council of Canada, Regulation Reference Technical Report No. 2).

Cairns, Robert D. (1985), "Rent Seeking, Deregulation and Regulatory Reform", Canadian Public Policy, Vol. 1(3), pp. 591-601.

Calabresi, Guido (1968) "Transaction Costs, Resource Allocation and Liability Rules - A Comment", Journal of Law and Economics, Vol 11, April, pp 67-73.

Cayne, D. and M.J. Trebilcock (1973) "Market Considerations in the Formulation of Consumer Protection Policy", University of Toronto Law Journal, Vol 23, pp 396-440.

Cheung, Steven N.S. (1979) "Rent Control and Housing Reconstruction: The Postwar Experience of Prewar Premises in Hong Kong", Journal of Law and Economics, Vol. 22 (1), pp. 27-53.

Coase, R.H. (1960) "The Problem of Social Cost", Journal of Law and Economics, Vol 3(1), pp 1-44.

Colantoni, C.S. et al. (1976) "Imperfect Information and Welfare Comparisons of Policies Concerning Information and Regulation", Bell Journal of Economics, Vol 7, pp 1145-1159.

Coleman, Jules L. (1984) "Economics and the Law: A Critical Review of the Foundations of the Economic Approach to Law", Ethics, Vol 94, July, pp 649-679.

Comfort, Louise K. (1981) "Goals and Means: The Problem of Specialization in the Development of Effective Public Policy", Adminstration and Society, Vol. 13(1), May, pp. 77-108.

Dahlman, Carl J. (1979) "The Problem of Externality", Journal of Law and Economics, Vol 22, (April), pp 141-162.

Dales, John H. (1975) "Beyond the Marketplace", Canadian Journal of Economics, Vol 8(4), (November), pp 483-503.

Dales, John H. (1983) "Distortions and Dissipations", Canadian Public Policy, Vol IX,(2), pp 257-263.

Daniels, Norman ed. (1975) Reading Rawls: Critical Studies of A Theory of Justice (Oxford: B. Blackwell).

Davies, J. Clarence III (1980) The Politics of Pollution (New York: Bobbs-Merrill).

Davis, O.A. and M.I. Kamien (1970) "Externalities, Information and Alternative Collective Action", in R.H. Haveman and J. Margolis (eds.) Public Expenditures and Policy Analysis, (Chicago: Markham Publishing), pp. 74-95.

Davis, O.A. and A. Whinston (1967) "Piecemeal Policy in the Theory of Second Best", Review of Economic Studies, Vol 34, pp 323-31.

de Jouvenel, Bertrand (1952) The Ethics of Redistribution (Cambridge: Cambridge University Press).

de Tocqueville, Alexis (1945) Democracy in America, trans Henry Reeve, rev. Francis Bowen (New York: Knopf). First edition published in 1835.

Demsetz, Harold (1968a) "The Cost of Transacting", Quarterly Journal of Economics, Vol 82, February, pp 33-53.

Demsetz, Harold (1968b) "Why Regulate Utilities?" Journal of Law and Economics, Vol 11, (April), pp 55-65.

Demsetz, Harold (1969) "Information and Efficiency: Another Viewpoint", Journal of Law and Economics, Vol. 12 (1), pp. 1-22.

Demsetz, Harold (1971) "Information and Efficiency: Another Viewpoint", in D.M. Lamberton (ed.) Economics of Information and Knowledge (Harmondsworth, U.K.: Penguin Books), pp 160-186.

Dewees, D.N. et al. (1975) Economic Analysis of Environmental Policies (Toronto: University of Toronto Press).

Dewey, Donald J. (1974) "Regulatory Reform?" in W.G. Shepherd and T.G. Gies (eds.) Regulation in Further Perpsective: The Little Engine That Might (East Lansing: Michigan State University), pp 27-40.

Doern, G. Bruce and Richard W. Phidd (1983) Canadian Public Policy: Ideas, Structure, Process (Toronto: Methuen).

Dorfman, R. (1969) "General Equilibrium with Public Goods," in J. Margolis and H. Guitton (eds.) Public Economics (London: Macmillan), pp 247-275.

Downs, Anthony (1957) "An Economic Theory of Political Action in a Democracy," Journal of Political Economy, Vol 65, pp 135-150.

Downs, Anthony (1965a) "A Theory of Bureaucracy," American Economic Review, Vol 55(2), May, pp 439-446.

Downs, Anthony (1965b) "Why the Government Budget is Too Small in a Democracy," in E. Phelps (ed.) Private Wants and Public Needs (New York: Norton).

Dworkin, Gerald et al. (eds.) (1977) Markets and Morals (Washington: Hemisphere Publishing Corp).

Dworkin, Ronald (1977) Taking Rights Seriously (Cambridge, Mass: Harvard University Press).

Eads, George and M. Fix (1984) Relief or Reforms? Reagan's Regulatory Dilemma (Washington: The Urban Institute).

Economic Council of Canada (1979) Responsible Regulation (Ottawa: Minister of Supply and Services).

Economic Council of Canada (1981) Reforming Regulation (Ottawa: Minister of Supply and Services).

Edelman, Murray (1967) The Symbolic Uses of Politics (Urbana: University of Illinois Press).

Edelman, Murray (1977) Political Language: Words that Succeed and Policies that Fail (New York: Academic Press).

Edsal, Thomas Byrne (1984) The New Politics of Inequality (New York: Norton).

Elford, E. Craig and W.T. Stanbury (1985), "Mixed Enterprises in Canada", in D.G. McFetridge (ed.) Canadian Industry in Transition (Toronto: University of Toronto Press).

Ellul, Jacques (1967) The Political Illusion (New York: A.A. Knopf).

Evans, R.G. (1982) "Slouching Toward Chicago: Regulatory Reform as Revealed Religion," Osgoode Hall Law Journal, Vol 20(3), pp 454-484.

Evans, R.G. and M.J. Trebilcock (1982), eds., Lawyers and the Consumers' Interest (Toronto: Butterworth's).

Evans, R.G. and A.D. Wolfson (1982) "Cui Bono--Who Benefits from Improved Access to Legal Services?" in Evans and Trebilcock (1982), eds., Lawyers and the Consumers' Interest (Toronto: Butterworth's) pp 3-32.

Fallis George B. and Lawrence B. Smith (1985), "Rent Control in Toronto: Tenant Rationing and Tenant Benefits", Canadian Public Policy, Vol. 11(3), pp. 543-550.

Fiorina, M.P. (1981) Retrospective Voting in American National Elections (New Haven: Yale University Press).

Frankel, Charles (1973) "The New Egalitarianism and the Old", Commentary, Vol. 56(3), pp. 54-61.

Freeman, A. Myrick (1969) "Income Redistribution and Social Choice: A Pragmatic Approach", Public Choice, Vol. 7, Fall, pp. 3-21.

Frieden, Bernard J. (1978) The Environmental Protection Hustle (Cambridge, Mass.: MIT Press).

Frieden, Bernard J. (1979) "The New Regulation Comes to Suburbia", The Public Interest, No. 55, Spring, pp 15-27

Furness, Norman and T. Tilton (1977) The Case for the Welfare State (Bloomington, Ind.: Indiana University Press).

Gillespie, W.I. (1964) The Incidence of Taxes and Public Expenditures in the Canadian Economy (Ottawa: Queen's Printer).

Gillespie, W.I. (1976) "On the Redistribution of Income in Canada", Canadian Tax Journal, Vol. 24(4).

Gillespie, W.I. (1981) "The State and Income Redistribution", Canadian Taxation, Vol. 3(3).

Goldberg, Victor P. (1976a) "Regulation and Administered Contracts", Bell Journal of Economics and Management Science, Vol 7 (Autumn) pp 426-448.

Goldberg, Victor P. (1977) "On Positive Theories of Redistribution", Journal of Economic Issues, Vol. 11(1) pp. 119-132.

Goldberg, Victor P. (1979) "Protecting the Right to be Served by Public Utilities", Research in Law and Economics, Vol 1, pp 145-56.

Goldberg, Victor P. (1976b) "Toward an Expanded Theory of Contract", Journal of Economic Issues, Vol. 10, pp. 45- .

Gorecki, P.K. and W.T. Stanbury (1984) The Objectives of Canadian Competition Policy, 1888-1983 (Montreal: The Institute for Research on Public Policy).

Gouldner, A.W. (1960), "The Norm of Reciprocity: A Preliminary Statement", American Sociological Review, Vol. 25.

Gray, Horace M. (1940) "The Passing of the Public Utility Concept", Journal of Land and Public Utility Economics, Vol 16, February, pp 8-20.

Gutmann, Amy (1980) Liberal Equality (London: Cambridge University Press).

Haksar, Vinit (1979) Equality, Liberty, and Perfectionism (Oxford: Oxford University Press).

Hamilton, Walton H. (1930) "Affectation With Public Interest", Yale Law Journal, Vol 39(8), pp 1089-1112.

Harberger, Arnold C. (1971) "Three Basic Postulates for Applied Welfare Economics: An Interpretive Essay", Journal of Economic Literature, Vol 9, pp 785-797.

Hardin, Garrett (1968) "The Tragedy of the Commons", Science, December 13, pp 1243-1248.

Hardin, Herschel (1974) A Nation Unaware: Canada's Economic Culture (Vancouver: J.J. Douglas).

Hartle, Douglas G. (1979) Public Policy Decision Making and Regulation (Montreal: Institute for Research on Public Policy).

Hartle, Douglas G. (1983) "The Theory of Rent Seeking: Some Reflections", Canadian Journal of Economics, Vol 16(4), pp 539-554.

Hartle, Douglas G. (1984) The Political Economy of Residential Rent Control in Ontario, Research Study No. 12 (Toronto: Ontario Commisison of Inquiry into Residential Tenancies).

Hayek, F.A. (1976) Law, Legislation and Liberty: Vol 2; The Mirage of Social Justice (London: Routledge & Kegan Paul).

Hayes, Michael T. (1978) "The Semi-Sovereign Pressure Groups", Journal of Politics February, pp 134-61.

Head, J.G. (1962) "Public Goods and Public Policy", Public Finance/Finance Publiques, Vol 17(2), pp 197-219.

Hilton, George W. (1972) "The Basic Behavior of Regulatory Commissions", American Economic Review, Vol 62 (May) pp 47-54.

Hirshleifer, J. and J.G. Riley (1979) "The Analysis of Uncertainty and Information -- An Expository Survey", Journal of Economic Literature, Vol 17, pp 1375-1421.

Hochman, H.M. and J.D. Rogers (1969) "Pareto Optimal Redistribution", American Economic Review, Vol 59, September, pp 542-56.

Hochschild, Jennifer (1981) What's Fair? American Beliefs About Distributive Justice (Cambridge, Mass.: Harvard University Press).

Hospers, John (1972) Human Conduct: Problems of Ethics (New York: Harcourt Brace Jovanovich), shorter edition.

Howard, J.L. and W.T. Stanbury (1984) "Measuring Leviathan: The Size, Scope and Growth of Government in Canada", in George Lermer (ed.) Probing Leviathan: An Investigation of Government in the Economy (Vancouver: The Fraser Institute), Ch. 4 and Appendix.

Hudec, A.J. and M.J. Trebilcock (1982) "Lawyer Advertising and the Supply of Information in the Market for Legal Services", University of Western Ontario Law Review, Vol 20(1), pp 53-93.

Hughes, J.R.T. (1976) Social Control in the Colonial Economy (Charlottesville: University Press of Virginia).

Hughes, J.R.T. (1977) The Governmental Habit: Economic Controls from Colonial Times to the Present (New York: Basic Books).

Hunter, M.H. (1917) "The Early Regulation of Public Service Companies", American Economic Review, Vol 7, September, pp 568-581.

Iles, C.M. (1903) "Early Stages of English Public House Regulation", Economic Journal Vol 8, June, pp 251-262.

Janis, Irving L. and Leon Mann (1977) Decision Making (New York: The Free Press).

Jencks, Christopher et al.(1972) Inequality: A Reassessment of the Effect of Family and Schooling in America (New York: Basic Books).

Jones, Gareth (1983) "Transactions Costs, Property Rights and Organizational Culture: An Exchange Perspective", Administrative Science Quarterly, Vol. 28 (3), pp. 454-467.

Jordan, W.A. (1972) "Producer Protection, Prior Market Structure, and the Effects of Government Regulation", Journal of Law and Economics, Vol 15, April, pp 151-176.

Joskow, Paul (1972) "The Determination of the Allowed Rate of Return in a Formal Regulatory Hearing", The Bell Journal of Economics and Management Science, Vol 3(3) (Autumn), pp 632-644.

Joskow, Paul (1973) "Pricing Decision of Regulated Firms: A Behavioural Approach", The Bell Journal of Economics and Management Science, Vol 4(3) (Autumn), pp 118-140.

Kahn, Alfred E. (1970, 1971) The Economics of Regulation: Principles and Institutions 2 Vols. (New York: John Wiley).

Kaiser, Gordon E. (1982) "Canada", in J.O. von Kalinowski, World Law of Competition (New York: Mathew Bender), Unit A, Vol. B.

Kapp, K. William (1963) Social Costs and Business Enterprise (New York: Asia Publishing House) (the 2nd edition of The Social Costs of Private Enterprise [1950]).

Kaufman, Herbert (1976) Are Government Organizations Immortal? (Washington, D.C.: Brookings Institution).

Kerlin, John J. (1982) The Political Economy of Fiscal Limits (Lexington Mass: D.C. Heath, Lexington Books).

Kirby, M.J.L., Chrmn. (1982) Navigating Troubled Waters: A New Policy for the Atlantic Fisheries (Ottawa: Minister of Supply and Services).

Knetsch, Jack L. et al. (1984) Residential Tenancies: Losses, Fairness and Regulations, Research Study No. 14 (Toronto: Ontario Commission of Inquiry into Residential Tenancies).

Kolko, G. (1965) Railroads and Regulation, 1877-1916 (Princeton: Princeton University Press).

Kristol, Irving (1972) "About Equality," Commentary, Vol. 54 (5), pp. 41-47.

Kristol, Irving (1977) Two Cheers for Capitalism (New York: Basic Books).

Kronman, A.T. (1980) "Wealth Maximization as a Normative Principle", Journal of Legal Studies, Vol 9, pp 227-42.

Krueger, Anne O. (1974): "The Political Economy of the Rent Seeking Society", American Economic Review, Vol 64(3), pp 291-303.

La Porte, Todd ed. (1975) Organized Social Complexity: Challenge to Politics and Policy (Princeton, N.J.: Princeton University Press).

Lasswell, Harold D. (1958) Politics: Who Gets What, When, and How (New York: Meridian; originally published in 1936).

Latham, Earl (1952) The Group Basis of Politics (Ithaca, N.Y.: Cornell University Press).

Lazarus, Simon (1974) The Genteel Populists (New York: Holt, Rinehart and Winston).

Leibenstein, Harvey (1976) Beyond Economic Man (Cambridge, Mass.: Harvard University Press).

Leland, H. (1979) "Quacks, Lemons, and Licensing: A Theory of Minimum Quality Standards", Journal of Political Economy, Vol 87, pp 1328-46.

Lermer, George and W.T. Stanbury (1985), "Measuring the Cost of Redistrbuting Income By Means of Direct Regulation", Canadian Journal of Economicsnn, Vol. 28(1), pp. 190-207.

Lett, Monica R. (1976) Rent Control: Concepts, Realities, and Mechanisms (New Bruswick, N.J.: Center for Urban Policy Research, Rutgers University).

Lindblom, Charles E. (1959) "The Science of 'Muddling Through'", Public Administration Review, Vol 19, Spring, pp 79-88.

Lipsey, Richard and Kelvin Lancaster (1956) "The General Theory of Second Best", Review of Economic Studies, Vol 24(1), December, pp 11-32.

Lovrich, N.P. and Max Neiman (1984) Public Choice Theory in Public Administration: An Annotated Bibliography (New York: Garland).

Lowi, Theodore (1969) The End of Liberalism (New York: Norton).

MacAvoy, P.W. (1965) The Economic Effects of Regulation: The Trunkline Railroad Cartels and the ICC before 1900 (Cambridge: MIT Press).

MacCrimmon, K.T. (1983) "Controlling Anticompetitive Behaviour in Canada: A Contrast to the United States", Osgoode Hall Law Journal, Vol. 21(4), pp. 569-608.

Mackaay, Ejan (1982) Economics of Information and Law (Higham, Mass.: Kluwer Boston Inc.).

Macneil, I.R. (1978) "Contracts Adjustment of Long-term Economic Relations under Classical, Neo-classical, and Relational Contract Law", Northwestern University Law Review, Vol. 72, p. 854- .

McCormick, Robert E. and Tollison, Robert D. (1981): Politicians, Legislation and the Economy: An Inquiry into the Interest Groups Theory of Government (Boston: Martinus-Nijhoff).

McCraw, Thomas K. (1975) "Regulation in America: A Review Article", Business History Review, Vol 49, Summer, pp 159-183.

McKenzie, R.B. (1978) "On the Methodological Boundaries of Economic Analysis," Journal of Economic Issues, Vol 12, pp 627-45.

McKie, James W. (1974) "The Ends and Means of Regulation", in C.F. Phillips (eds.) Competition and Monopoly in the Domestic Telecommunications Industry (Lexington Va: Washington and Lee University), pp 9-28. Brookings General Series Reprint 287.

McKie, James W. (1970) "Regulation and the Free Market: The Problem of Boundaries", Bell Journal of Economics and Management Science, Vol 1(1), Spring, pp 6-26.

Manne, Henry ed. (1975) Economics of Legal Relationships (St. Paul, Minn.: West Publishing).

March, James G. (1962) "The Business Firm as a Political Coalition", World Politics, Vol 14, November, pp 662-78.

March, James (1978) "Bounded Rationality, Ambiguity and the Engineering of Choice", Bell Journal of Economics, Vol 9, pp 587-608.

March, James G. and H.A. Simon (1958) Organizations (New York: John Wiley).

Marmor, Theodore (1973) The Politics of Medicare (Chicago: Aldine).

Maslove, Allan and Gene Swimmer (1978) Wage Controls in Canada 1975-78: A Study of Public Decision Making (Montreal: The Institute for Research on Public Policy).

Meade, J.E. (1965) Efficiency, Equality and the Ownership of Property (Cambridge,Mass: Harvard University Press).

Meadow, Robert G. (1980) Politics as Communication (Norwood, N.J.: Albex Publishing).

Meir, K.J. and J.P. Plumlee (1978) "Regulatory Administration and Organizational Rigidity", Western Political Quarterly, Vol 31(1), March, pp 80-95.

Migue, Jean-Luc (1979) Nationalistic Policies in Canada: An Economic Approach (Montreal: C.D. Howe Research Institute).

Mishan, Ezra J. (1978) "The Folklore of the Market: An Inquiry into the Economic Doctrine of the Chicago School", in W.J. Samuels (ed.) The Chicago School of Political Economy (East Lansing, Mich.: Associaton of Evolutionary Economics and Michigan State University), pp. 95-166.

Mishan, Ezra J. (1981) Introduction to Normative Economics (New York: Oxford University Press).

Mueller, Dennis, C. (1979) Public Choice, Cambridge Surveys of Economic Literature (Cambridge: Cambridge University Press).

Musgrave, R.A. (1958) The Principles of Public Finance (New York: McGraw Hill).

Musgrave, R.A. (1969) "Provision for Social Goods", in J. Margolis and H. Guitton (eds.) Public Economics (London: Macmillan), pp 124-144.

Myrdal, Gunnar (1965) The Political Element in the Development of Economic Theory (Cambridge, Mass.: Harvard University Press).

Myrdal, Gunnar (1978) "Institutional Economics", Journal of Economic Issues, Vol. 12 (4), pp. 771-783.

Nadel, Mark (1978) Consumer Protection: Gains and Setbacks (Washington, D.C., Congressional Quarterly).

Nakamura, Robert T. and Frank Smallwood (1980) The Politics of Policy Implementation (New York: St. Martins Press).

Nelkin, Dorothy ed. (1979) Controversy: The Politics of Technical Decisions (Beverly Hills Calif: Sage Publications).

Nisbet, Robert (1974) "The Pursuit of Equality", The Public Interest, No. 35, Spring, pp. 103-120.

Noll, Roger G. and Bruce M. Owen (1983) The Political Economy of Deregulation: Interests Groups in the Regulatory Process (Washington, D.C.: American Enterprise Institute).

North, Douglass, C. (1979) "A Framework for Analyzing the State in Economic History", Explorations in Economic History, Vol 16(3), July, pp 249-59.

Nozick, Robert (1974) Anarchy, State and Utopia (New York: Basic Books).

Okun, Arthur M. (1975) Equality and Efficiency: The Big Tradeoff (Washington. D.C.: Brookings Institution).

Olsen, E.O. (1969) "A Normative Theory of Transfers", Public Choice, Vol 24 Spring, pp. 39-58.

Olson, Mancur (1965) The Logic of Collective Action (Cambridge: Harvard University Press).

O'Sullivan, John (1981) "Is Mrs. Thatcher Curing the British Disease?" in J.F. Gatti (ed.) The Limits of Government Regulation (New York: Academic Press), pp 59-85.

Osberg, Lars (1981) Economic Inequality in Canada (Toronto: Butterworth's).

Ouchi, W.G. (1980) "Markets, Bureaucracies and Clans", Administrative Science Quarterly, Vol. 25, pp. 129-141.

Page, Benjamin I. (1983) Who Gets What from Government (Los Angeles: University of California Press).

Panzer, J.C. and R.D. Willig (1977a) "Free Entry and Sustainability of Natural Monopoly", Bell Journal of Economics, Vol 8(1), pp 1-22.

Panzer, J.C. and R.D. Willig (1977b) "Economies of Scale in Multi-Output Production", Quarterly Journal of Economics, Vol 91 August, pp 481-493.

Peacock, Alan and J.C. Rowley (1972) "Pareto-Optimality and the Political Economy of Liberalism", Journal of Political Economy, Vol 80, pp 476-490.

Peltzman, Sam (1976) "Toward a More General Theory of Regulation", Journal of Law and Economics, Vol 19(2), pp 211-248.

Pennock, J.R. and J.W. Chapman (eds.) (1967) Nomos IX: Equality (New York).

Petty, Sir William (1662) A Treatise on Taxes & Contributions (London: N. Brooke) as reprinted in C.H. Hull (ed.) The Economic Writings of Sir William Petty (Cambridge: Cambridge University Press, 1899) Vol 1, pp

Phelps, E.S. ed. (1975) Altruism, Morality, and Economic Theory (New York: Russel Sage Foundation).

Phillips, Almarin (1978) "Regulation and its Alternatives", in Regulating Business: The Search for an Optimum (San Francisco: The Institute for Contemporary Studies).

Phillips, C.F. (1969) Economics of Regulation rev. ed. (Homewood, Ill.: R.D. Irwin) Ch. 3, "The Legal Concept of Public Regulation."

Pigou, A.C. (1932) The Economics of Welfare (London: Macmillan).

Pipes, Sally and Michael Walker (1984) Tax Facts 4: The Canadian Consumer Tax Index and You (Vancouver: The Fraser Institute).

Polinsky, A. Mitchell (1983) Introduction to Law and Economics (Boston: Little, Brown and Co.).

Porter, Michael and Jeffrey Saganstry (1976) "Information, Politics and Economic Analysis: The Regulatory Decision Process in the Air Freight Case", Public Policy, Vol 24(2), Spring, pp 264-307.

Posner, Richard A. (1969) "Natural Monopoly and Its Regulation", Stanford Law Review, Vol 21(3), February, pp 548-643 (see comments SLR, Vol 22(3), February 1970, pp 510-546 by Comanor, Swidler, Shepherd and reply by Posner).

Posner, Richard A. (1971) "Taxation by Regulation", Bell Journal of Economics and Management Science, Vol 2(1), (Spring), pp 22-50.

Posner, Richard A. (1973) "Economic Justice and the Economist", The Public Interest, No. 33, Fall, pp. 109-119.

Posner, Richard A. (1974) "Theories of Economic Regulation", Bell Journal of Economics and Management Science, Vol 5(2) (Autumn), pp 335-358.

Posner, Richard A. (1981) The Economics of Justice (Cambridge, Mass.: Harvard University Press).

Preston, M. (1972) Public Goods and The Public Sector (London: Macmillan).

Priest, A.J.G. (1964a) "Discrimination: Bane of Regulators and Regulated", Public Utilities Fortnightly, Vol 74(4), August 13, pp 9-34.

Priest, A.J.G. (1964b) "Some Bases of Public Utility Regulation", Mississippi Law Journal, Vol 36, pp 18-29.

Proudfoot, Stuart (1980) "Private Wants and Public Needs: The Regulation of Land Use in the Metropolitan Toronto Area" (Ottawa: Economic Council of Canada, Regulation Reference, draft paper).

Quade, E.S. (1975) Analysis for Public Decisions (New York: American Elsevier).

Quinn, John and Michael Trebilcock (1981) "Compensation, Transition Costs and Regulatory Change" (Ottawa: Economic Council of Canada, Regulation Reference Working Paper No. 18).

Rees, John (1971) Equality (New York: Praeger).

Reschenthaler, G.B. and W.T. Stanbury (1983), "Deregulating Canada's Airlines: Grounded by False Assumptions", Canadian Public Policy, Vol. 9(2), pp. 210-222.

Rogers, James D. (1974) "Explaining Income Redistribution", in H.M. Hochman and G.E. Peterson (eds.) Redistribution Through Public Choice (New York: Columbia University Press, in cooperation with the Urban Institute, Washington, D.C.), pp 165-205.

Rothbard, Murray N. (1962) Man, Economy and State 2 Vols. (Princeton, N.J.: Van Nostrand).

Rubin, Bernard (1977) Media, Politics, and Democracy (New York: Oxford University Press).

Runciman, W.G. (1972) Relative Deprivation and Social Justice (London: Routledge and Kegan Paul).

Russell, M. and P.B. Shelton (1974) "A Model of Regulatory Agency Behaviour", Public Choice, Vol 14 (Spring), 11-26.

Sabatier, P.A. (1975) "Social Movements and Regulatory Agencies: Toward a More Adequate--and Less Pessimistic--Theory of 'Clientele Capture'", Policy Sciences, Vol 6, pp 301-342.

Sahota, G.S. (1978) "Theories of Personal Income Distribution: A Survey", Journal of Economic Literature, Vol 26, March, pp 1-55.

Samuels, W.J. (1972) "In Defense of a Positive Approach to Government as an Economic Variable", Journal of Law and Economics, Vol 15, pp 453-591.

Samuels, Warren J. (1978) "Toward Positive Public Choice Theory", Review of Social Economy, Vol 38(1), pp 55-64.

Samuelson, P.A. (1954) "The Pure Theory of Public Expenditure", Review of Economics and Statistics, Vol 36 November, pp 387-89.

Samuelson, P.A. (1955) "Diagrammatic Exposition of a Theory of Public Expenditure", Review of Economics and Statistics, Vol 37, pp 350-56.

Samuelson, P.A. (1958) "Aspects of Public Expenditure Theories", Review of Economics and Statistics, Vol 40, pp 332-38.

Samuelson, P.A. (1969) "Pure Theory of Public Expenditure and Taxation", in J. Margolis and H. Guitton (eds.) Public Economics (London: Macmillan), pp 98-123.

Schaefer, D.L., ed. (1979a) The New Egalitarianism: Questions and Challenges (Port Washington, NY: Kennikat Press).

Scherer, F.M. (1980) Market Structure and Economic Performance (Chicago: Rand, McNally).

Schlesinger, James R. (1968) "Systems Analysis and the Political Process", Journal of Law and Economics, Vol. 11 (2), pp. 281-298.

Schmalensee, Richard (1979) The Control of Natural Monopolies (Lexington, Mass.: D.C. Heath).

Schultz, Charles L. (1977) The Public Use of Private Interest (Washington D.C.: Brooking Institution).

Schwartz, A., and L.L.Wilde (1979) Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis", University of Pennsylvania Law Review, Vol 127, pp 630-682.

Schwert, G. William (1977) "Public Regulation of National Securities Exchanges: A Test of the Capture Hypothesis", Bell Journal of Economics, Vol 8(1) (Spring), pp 128-50.

Scott, Anthony and Philip A. Neher, eds. (1981) The Public Regulation of Commercial Fisheries in Canada (Ottawa: Minister of Supply and Services).

Sen, A. (1977) "Rational Fools: A Critique of the Behavioural Foundations of Economic Theory", Philosophy and Public Affairs, Vol 6, pp 317- .

Sherba, James P. (1980) The Demands of Justice (Notre Dame: University of Notre Dame Press).

Shibata, Hirofumi (1979) "A Theory of Group Consumption and Group Formation", Public Finance/Finances Publiques, Vol 34(3), pp 395-413.

Shoup, C.S. (1969) Public Finance (Chicago: Aldine Publishing).

Simon, Herbert (1964) "On the Concept of Organizational Goal", Administrative Science Quarterly, Vol 9 June, pp 1-22.

Smith, Adam (1776) An Inquiry into the Nature and Causes of the Wealth of Nations (New York: Random House, Modern Library Edition, 1937, Edwin Cannan, ed.).

Sowell, Thomas (1980) Knowledge and Decision (New York: Basic Books).

Sowell, Thomas (1981) "Poverty, the Distribution of Income and Social Policy: Some Thoughts", in J.F. Gatte (ed.) The Limits of Government Regulation (New York: Academic Press), pp 35-56.

Spencer, Herbert (1884) Man versus the State (London: Williams and Norgate).

Sprengler, J.J. (1969) "Evolution of Public Utility Regulation: Economists and Other Determinants", South African Journal of Economics, Vol 37, pp 3-31.

Stanbury, W.T. (1983) "Provincial Regulation and Federal Competition Policy", Windsor Yearbook of Access to Justice, Vol 3, pp 291-347.

Stanbury, W.T. (1985) The Normative Bases of Rent Regulation, Research Study No. ____ (Toronto: Ontario Commission of Inquiry into Residential Tenancies).

Stanbury, W.T. and Jane Fulton (1984), "Suasion as a Governing Instrument", in Allan M. Maslove (ed.) How Ottawa Spends, 1984: The New Agenda (Toronto: Methuen), pp. 282-324.

Stanbury, W.T. and Peter Thain (1985) The Origins of Rent Regulation in Ontario, Research Study No. 17 (Toronto: Ontario Commission of Inquiry into Residential Tenancies).

Stanbury, W.T. and Ilan B. Vertinsky (1985) Rent Regulation: Design Characteristics and Effects, Research Study No. 18 (Toronto: Ontario Commission of Inquiry into Residential Tenancies).

Stigler, George J. (1959) "The Politics of Political Economists", Quarterly Journal of Economics, Vol. 73(4), November, pp. 522-32.

Stigler, George J. (1961) "The Economics of Information", Journal of Political Economy, Vol 69, pp. 213-25.

Stigler, George J. (1965) "The Economist and the State", American Economic Review, Vol. 5(1), March, pp. 1-18.

Stigler, George J. (1970) "Director's Law of Public Income Redistribution", Journal of Law and Economics, Vol 13, April, pp 1-11.

Stigler, George J. (1971) "The Theory of Economic Regulation", Bell Journal of Economics and Management Science, Vol 2(1) (Spring), pp 1-21.

Stigler, George J. (1972a) "The Process of Economic Regulation", Antitrust Bulletin, Vol 17, Spring, pp 207-235.

Stigler, George J. (1972b) "The Law and Economics of Public Policy: A Plea to the Scholars", Journal of Legal Studies, Vol. 1 (1), pp. 1-12.

Stigler, George J. (1974) "Free Riders and Collective Action: An Appendix to Theories of Economic Regulation", Bell Journal of Economics and Management Science, Vol 5(2), Autumn, pp 359-365.

Stigler, George J. (1975) The Citizen and the State: Essays on Regulation (Chicago: University of Chicago Press).

Stigler, George J. (1982) "Economists and Public Policy", Regulation, May/June, pp. 13-17.

Stigler, George J. and Claire Friedland (1962) "What Can the Regulators Regulate? The Case of Electricity", Journal of Law and Economics, Vol 5, pp. 1-16.

Swaigen, John Z. (1981) Compensation of Pollution Victims in Canada (Ottawa: Minister of Supply and Services).

Tawney, R.H. (1952) Equality 4th rev. ed. (London: Allan and Unwin).

Thayer, Frederick C. (1984) Rebuilding America: The Case for Economic Regulation (New York: Praeger).

Thompson, Fred (1980) "Regulatory Reform and Deregulation in the United States", in W.T. Stanbury (ed.) Government Regulation: Scope, Growth, Process (Montreal: The Institute for Research on Public Policy), pp 193-238.

Thurow, Lester (1973) "Towards a Definition of Economic Justice", The Public Interest, No. 31, Spring, pp 56-80.

Thurow, Lester C. (1981) The Zero-Sum Society: Distribution and the Possibilities for Economic Change (Harmandsworth: Penguin Books).

Tobin, James (1970) "On Limiting the Domain of Inequality", Journal of Law and Economics, Vol. 13 (2), pp. 263-277.

Trebilcock, M.J. (1982) "Competitive Advertising", in Evans and Trebilcock (1982), Lawyers and the Consumers' Interest (Toronto: Butterworths), pp 143-60.

Trebilcock, M.J., C.J. Tuohy and Alan Wolfson (1979) Professional Regulation: A Staff Report for the Ontario Professional Organizations Committee (Toronto: Ontario Queen's Printer).

Trebilcock, M.J., Leonard Waverman and J. Robert S. Prichard (1978) "Markets for Regulation: Implications for Performance Standards and Institutional Design", in Government Regulation: Issues and Alternatives, 1978 (Toronto: Ontario Economic Council) pp 11-66.

Trebilcock, M.J. et al. (1981) The Choice of Governing Instrument: Some Applications (Ottawa: Economic Council of Canada, Regulation Reference Technical Report No. 12).

Trebilcock, M.J. et al. (1982) The Choice of Governing Instrument (Ottawa: Minister of Supply and Services).

Trebing, Harry M. (1977) "Broadening the Objectives of Public Utility Regulation", Land Economics, Vol 53(1), February, pp 106-122.

Troeltsch, Ernst (1931) The Social Teachings of the Christian Churches (London: Allen and Unwin). Trans. by Oline Whyon.

Tuck, Richard (1979) Natural Rights Theories: Their Origin and Development (Cambridge: Cambridge University Press).

Tullock, Gordon (1965) "Entry Barriers in Politics", American Economic Review, Vol 55(2), May, pp 458-466.

Tullock, Gordon (1971) "The Charity of the Uncharitable", Western Economic Journal, Vol 9, December, pp 379-92.

Tullock, Gordon (1975) "The Transitional Gains Trap", Bell Journal of Economics and Management Science, Vol 6 Spring, pp 671-78.

Tullock, Gordon (1980) "Rent Seeking as a Negtive-Sum Game", in J.M. Buchanan, R.D. Tollison and G. Tullock (eds.) Toward a Theory of a Rent-Seeking Society (College Station: Texas A&M University Press), pp 16-36.

van den Haag, Ernest (1976) "Economics is not Enough--Notes on the Anti-capitalist Spirit", The Public Interest No. 45, Fall, pp 109-122.

Viner, Jacob (1960) "The Intellectual History of Laissez Faire", Journal of Law and Economics, Vol 3, October, pp 45-69.

Vogel, David, (1980-81) "The Public Interest Movement and the American Reform Tradition", Political Science Quarterly, Vol 95 Winter, pp 607-28.

Vogel, David (1981) "The 'New' Social Regulation in Historical and Comparative Perspective", in T.K. McCraw (ed.) Regulation in Perspective (Boston: Division of Research, Graduate School of Business Administration, Harvard University), pp 155-185, 238-245.

Weaver, Paul H. (1978) "Regulation, Social Policy and Class Conflict", The Public Interest, No. 50, Winter pp 45-63.

Webb, Sidney and Beatrice Webb (1911) The Prevention of Destitution Sp. ed. (London).

Weingast, Barry (1978) "A Positive Model of Public Policy Formulation: The Case of Regulatory Agency Behaviour", (St Louis: Center for the Study of American Business, Washington University, Working Paper No. 25).

Weinrib, A. (1971), "The Ontario Landlord and Tenant Amendment Act", University of Toronto Law Journal, Vol. 21, pp. 93 ---.

Weisbrod, Burton A. (1970), "Collective Action and the Distribution of Income: A Conceptual Approach", in R.H. Haveman and J. Margolis (eds.), Public Expenditures and Policy Analysis (Chicago: Markham PUblishing), pp. 117-141.

Weldon, T.D. (1953) The Vocabulary of Politics (Baltimore: Penguin).

Wilensky, Harold L. (1974) The Welfare State and Equality: Structural and Ideological Roots of Public Expenditure (Berkeley, Calif: Univeristy of California Press).

Williams, Bernard (1962) "The Idea of Equality", in Peter Laslett and W.G. Runciman (eds.) Philosophy, Politics and Society 2nd ser. (Oxford: Blackwell), pp 110-131. Also reprinted in Joel Feinberg (ed.) Moral Concepts (New York: Oxford University Press, 1969).

Williamson, O.E. (1975) Markets and Hierachies: Analysis and Antitrust Implications (New York: The Free Press).

Williamson, O.E. (1979) "Transaction-Cost Economics: The Governance of Contractual Relations", Journal of Law and Economics, Vol 22, October, pp 233-261.

Willig, Robert D. (1979) "Multi-product Technology and Market Structure", American Economic Review, Vol 69(2), pp 346-351.

Wilson, James Q. (1974) "The Politics of Regulation", in James W. McKie (ed.) Social Responsibility and the Business Predicament (Washington, D.C.: Brookings Institution, 1974), pp 134-168.

Wilson, James Q. ed. (1980) The Politics of Regulation (New York: Basic Books).

Wolf, Charles (1979) "A Theory of Non-Market Failure: Framework for Implementation Analysis", Journal of Law and Economics Vol 22(1), April, pp 107-139 (see also a slightly different version in The Public Interest, No. 55, Spring 1979, pp 114-133).

Wolff, Robert Paul (1977) Understanding Rawls: A Reconstruction and Critique of 'A Theory of Justice' (Princeton, N.J.: Princeton University Press).

Wright, Arthur R. (1963) "An Examination of the Role of the Board of Transport Commissioners for Canada as a Regulatory Tribunals", Canadian Public Administration, Vol 6(4), December, pp 349-385.

Wrong, Dennis H. (1979) Power: Its Forms, Bases, and Uses (New York: Harper & Row).

Wyman, Bruce (1904) "The Law of the Public Callings as a Solution of the Trust Problem", Harvard Law Review, Vol 17, pp 156-173, 217-247.

Wyman, Bruce (1911) "State Control of Public Utilities", Harvard Law Review, Vol. 24, June, pp. 624-634.

Zeckhauser, Richard (1970) "Uncertainty and the Need for Collective Action", in R.H. Haveman and J. Margolis (eds.) Public Expenditures and Policy Analysis (Chicago: Markham Publishing), pp. 96-116.

Zeckhauser, Richard (1974) "Risk Spreading and Distribution", in H.M. Hochman and G.E. Peterson (eds.) Redistribution Through Public Choice (New York: Columbia University Press), pp. 206-228.

Zeckhauser, Richard & Elmer Schaefer (1968) "Public Policy and Normative Economic Theory", in R.A. Bauer & K.J. Gergen (eds.) The Study of Policy Formation (New York: The Free Press), pp 27-101.

Research Studies

The following is a list of papers commissioned by the Inquiry.

No.

1 Slack, Enid and Sherry Glied. Rent Registry Alternatives.

2 Reid, Frank. Collective Bargaining for Tenants.

3 Jaffary, Karl D. Problems in the Regulation of Rents for Roomers and Boarders.

4 MacDonald, Daniel V. Constitutional Reference Re: The Residential Tenancies Act.

5 Fallis, George. Possible Rationales for Rent Regulation.

6 Hulchanski, J. David. Market Imperfections and the Role of Rent Regulations in the Residential Rental Market.

7 Sharp, Campbell, Pannell Kerr Forster Campbell Sharp. Survey of Financial Performance of Landlords.

8 Marks, Denton. Housing Affordability and Rent Regulation.

9 Steele, Marion and John Miron. Rent Regulation, Housing Affordability Problems, and Market Imperfections.

10 Clayton Research Associates Limited. Rent Regulation and Rental Market Problems.

11 Makuch, Stanley M. and Arnold Weinrib. Security of Tenure.

12 Hartle, D.G. The Political Economy of Residential Rent Control in Ontario.

13 Slack, Enid and David P. Amborski. The Distributive Impact of Rent Regulation.

14 Knetsch, Jack L., Daniel Kahneman and Patricia McNeill. Residential Tenancies: Losses, Fairness and Regulations.

15 Stanbury, W.T. Normative Bases of Rent Regulation.

16 Stanbury, W.T. Normative Bases of Government Action.

17 Stanbury, W.T. and P. Thain. The Origins of Rent Regulation in Ontario.

18 Stanbury, W.T. and I.B. Vertinsky. Rent Regulation: Design Characteristics and Effects.

19 Chant, John. Overview of Alternative Rental Housing Policies.

20 Foot, David K. Housing Demands: A Demographic Perspective.

21 Quirin, G. David. Regulatory Systems and their Applicability to Rent Controls.

22 Mascall, M. and Associates. Report of the Ontario Rental Housing Market.

23 Environics Research Group Limited. Financing Residential Rental Accommodation: A Survey.

24 Ekos Research Associates Inc. A Study of Landlords and Rent Regulation.

25 des Rosiers, Francois. A Rent Control System in Quebec.

26 Slack, Enid. The Costs of Rent Review in Ontario.

27 Muller, Andrew. Workable Rent Regulation: A Synthesis.

The following is a list of papers prepared by the research staff of the Inquiry.

28 Adams, Eric B., Pearl Ing and John Pringle. A Review of the Literature Relevant to Rent Regulation.

29 Adams, Eric B., Pearl Ing, Janet Ortved and Mary Jane Park. Government Intervention in Housing Markets: An Overview.

30 Pringle, John. Ontario's Residential Tenancies: A Statistical Profile.